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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

vs.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

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QUESTIONS PRESENTED

1. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional under the foreign Commerce Clause.

2. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional where such application imposes discriminatory compliance burdens on such entities.

3. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, intrudes into an inherently federal area and is preempted by the United States Constitution.

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

PETITION FOR WRIT OF CERTIORARI

This petition for a writ of certiorari seeks this Court's review of the judgment of the Supreme Court of California on a nationally and internationally important matter relating to the limitations under the United States Constitution on the power of the states to apportion and tax the income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, under worldwide combined reporting.

OPINIONS BELOW

The opinion of the Supreme Court of California (Appendix A)[1] is reported at 2 Cal. 4th 708 (1992). The opinion of the Court of Appeal of the State of California in and for the Third Appellate District (App. B) was reported at 232 Cal. App. 3d 1187 (1990) and again at 3 Cal. App. 4th 1034 (1990) to permit tracking of the case pending review by the California Supreme Court. Pursuant to the California Rules of Court, Rule 976(d), the opinion of the Court of Appeal was vacated by the Supreme Court of California's grant of review on February 28, 1991. The Statement of Decision of the California Superior Court (App. C) is an unreported decision.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the plaintiffs and respondents were Barclays Bank International Limited, a United Kingdom corporation, and Barclays Bank of California, a California corporation which was wholly owned by Barclays Bank International Limited. As appears in the Rule 29.1 Statement, Barclays Bank International Limited was merged with Barclays Bank PLC and Barcal was sold to Wells Fargo & Company with the present tax matters and claims for refund being assumed by Barclays Bank PLC.

RULE 29.1 STATEMENT

Pursuant to Rule 29.1 of the Rules of this Court, petitioner states during the income year 1977, Barclays Bank International Limited ("BBI"), a United Kingdom corporation, was a wholly owned subsidiary of Barclays Bank Limited ("BBL"), also a United Kingdom corporation. During income year 1977, Barclays Bank of California ("Barcal"), a domestic corporation, was a wholly owned subsidiary of BBI. On February 15, 1982, BBL reregistered as a public company under the provisions of the

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[1] All references to the appendices in this petition are denominated "App." followed by the letter to each item and, where necessary, a page reference.

Companies Act 1980 of the United Kingdom and changed its name to Barclays Bank PLC. On January 1, 1985, under the terms of the Barclays Bank Act 1984 of the United Kingdom, the United Kingdom banking business of Barclays Bank PLC was merged with the international and other overseas banking operations of BBI under the name Barclays Bank PLC. The ultimate parent of Barclays Bank PLC is now Barclays PLC, listed on the London Stock Exchange. On February 20, 1988, Barclays Bank PLC sold the stock of Barcal to Wells Fargo & Company. Under the terms of the agreement, Barclays Bank PLC assumed any tax liability at issue herein and retained all claims for refund. Barclays Bank PLC's non-wholly owned subsidiaries are listed in Appendix E to this petition.

JURISDICTION

The decision of the Supreme Court of California in these actions was rendered on May 11, 1992. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant portions of the following constitutional and statutory provisions are reproduced in Appendix D: Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause); Article VI, Clause 2 of the United States Constitution (the Supremacy Clause); and California Revenue & Taxation Code Section 25101.

STATEMENT

The issues raised by this case — issues specifically reserved by this Court in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) — concern the powers of a state to tax a domestic corporation with a foreign parent, or a foreign corporation with either a foreign parent or foreign subsidiaries, under worldwide combined reporting. The precise question presented is whether California's application of worldwide combined reporting to Barcal, a domestic corporation with a foreign parent, and to

BBI, a foreign corporation with a foreign parent and foreign subsidiaries, is unconstitutional.

California's action already has caused serious national and international repercussions, and the United States has appeared as amicus curiae in the courts below to assert that this action is "patently unconstitutional."[2]

1. THE BUSINESS OF THE BARCLAYS GROUP.

In 1977 Barcal and BBI, the California taxpayers, were part of the Barclays Group, a United Kingdom banking group of over 220 corporations doing business in some 60 nations.[3] The ultimate parent, BBL (now Barclays Bank PLC), was one of the United Kingdom clearing banks. Only two of such subsidiaries (Barcal and Barclays Bank of New York) were incorporated in the United States and only one other subsidiary, BBI, also did business in the United States. The Barclays Group conducted over ninety-eight percent (98%) of its business outside the United States. The Barclays Group was and is involved in all phases of international banking, including retail, merchant, and commercial banking, leasing and consumer credit and finance.

BBI was a corporation organized under the laws of England and was domiciled and doing business in the United Kingdom. BBI also did business in over 33 nations and territories outside the United Kingdom including the United States. BBI operated a banking agency in California. BBI itself owned, directly or indirectly, more than fifty percent (50%) of over 70 subsidiary corporations which operated in approximately 34 nations and territories outside the United Kingdom. Barcal, a California banking corporation, was a wholly owned subsidiary of BBI.

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[2]The United States appeared as amicus curiae in the California Superior Court, Court of Appeal and Supreme Court. The brief filed in the California Supreme Court is reproduced at App. F.

[3]BBI and BBL agreed for purposes of the litigation that they were members of a worldwide unitary business for 1977. App. C at 42.

2. THE INTERNATIONAL STANDARD FOR DIVISION OF INCOME AMONG NATIONS FOR TAX PURPOSES.

The United States, the United Kingdom and other nations of the world divide the income of multinational enterprises among nations for tax purposes by the arm's length separate accounting method ("the arm's length method"). The arm's length method treats each corporation as "an independent entity dealing at arm's length with its affiliated corporations, and subject to taxation only by the jurisdictions in which it operates and only for the income it realizes on its own books." *Container*, 463 U.S. at 185. Where a corporation crosses national boundaries, the host (non-domiciliary) country taxes that corporation only on the profits earned in the host country and as if those profits were earned by a separate enterprise.

The United States has been a leader in establishing the arm's length method as the international standard. Both the United States and its trading partners use this standard in all bilateral tax treaties and in their internal tax laws. The standard is "universally used and favored" by the nations of the world both "as an ideal and as a working methodology." App. C at 20-21. The arm's length standard is the international practice. *Container*, 463 U.S. at 184.

California uses a different and incompatible method to divide the income of a multinational enterprise for tax purposes — worldwide combined reporting. This method aggregates the income of all entities which form a part of the unitary business wherever they do business and determines California's share of this aggregate income by a formula, generally the average of the property, payroll and sales within and without California.

California worldwide combined reporting requires worldwide tax information for all members of the unitary group, not just for taxpayers. The income allocated to a tax jurisdiction under the arm's length method can and does differ substantially from the income apportioned to that jurisdiction under worldwide combined reporting. There is no way to reconcile these differences.

Only a handful of states of the United States have ever used worldwide combined reporting. No *nation* uses worldwide combined reporting.

3. THE IMPACT OF CALIFORNIA'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO FOREIGN OWNED MULTINATIONALS.

In the early 1970's respondent first extended worldwide combined reporting to foreign owned multinationals. The extension of this conflicting method into the international arena brought immediate complaints from both foreign business and foreign governments. Foreign governments bombarded the United States government with formal and informal diplomatic protests about worldwide combined reporting as applied to foreign multinationals. These included diplomatic notes from virtually every developed country in the world, protestations from heads of nations including Prime Minister Thatcher of the United Kingdom, Prime Minister Nakasone of Japan, and Prime Minister Trudeau of Canada directly to the President, delay in Treaty negotiations by the Netherlands and West Germany, and strong representations from the French, Danish, Italian and German governments. The Canadian and French tax treaty negotiators insisted on an exchange of notes which called attention to their concerns and which obligated the United States to reopen discussions with each country if an acceptable solution could be devised. There were even unprecedented direct foreign government attempts at persuasion at the state level.

Finally, in 1985, after years of diplomatic effort, the United Kingdom enacted retaliatory legislation which would deny certain treaty benefits for United States corporations operating in unitary states. The legislation had a chilling effect on the willingness of United Kingdom subsidiaries of such corporations to repatriate dividends.

The Federal Executive has steadfastly promoted and adhered to a policy of the use of arm's length separate entity accounting for the division of international income and opposed the use of worldwide combined reporting through *all* administrations confronted with this issue. Initially, the United States added Arti-

cle 9(4) to the tax treaty then being negotiated with the United Kingdom.[4] Article 9(4) would have required states to use the arm's length method when taxing affiliates of United Kingdom companies. Although a reservation which would remove Article 9(4) from the Treaty was defeated in both the Senate Foreign Relations Committee and the full Senate, the majority vote of the Senate for the Treaty including Article 9(4) fell five votes short of the two-thirds majority necessary for ratification. The Treaty was resurrected after parliamentary maneuvering in which the reservation was added without a separate vote, and the Treaty, with the reservation, was ratified by the Senate.[5] The United Kingdom House of Commons ratified the Treaty only after strong assurances from the United States that the matter of worldwide combined reporting would be resolved. The United States has continued with efforts at resolution. The appearance of the United States as amicus curiae in all three California courts below in support of BBI and Barcal is a part of such efforts.

Congress has enacted no legislation dealing with this issue. Bills concerning unitary taxation have been introduced, but there has never been a vote in a congressional committee or in either house of Congress on such a bill. None of the bills has dealt solely with worldwide combined reporting as applied to foreign multinational enterprises.

4. THE ASSESSMENTS.

Respondent California Franchise Tax Board audited the California tax returns of BBI and Barcal for 1977 and determined that BBI and Barcal were part of a worldwide unitary business conducted by the members of the Barclays Group. Respondent assessed additional taxes of $4,076 to BBI and $254,699 to Barcal, subsequently reduced during the administrative process to $1,678 and $152,420, respectively. BBI and Barcal paid the additional assessed taxes and filed suit for refund, challenging the constitu-

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[4]The United States/United Kingdom Income Tax Convention is hereafter referred to as the US/UK Treaty or Treaty.

[5]The reservation was included in the Third Protocol to the Treaty which also contained other changes.

tionality of the application of worldwide combined reporting to foreign owned multinational groups.

5. THE PROCEEDINGS BELOW.

A. How the Federal Questions Were Raised and Passed On Below.

In their complaints and briefs in the California Superior Court, and in their briefs in the California Court of Appeal and in the California Supreme Court, BBI and Barcal contended, inter alia, that the foreign Commerce Clause of the United States Constitution precluded the application of worldwide combined reporting to taxpayers that are members of a foreign owned and controlled unitary group. These courts explicitly noted and ruled on these constitutional contentions.

B. The Decisions Below.

(i) California Superior Court and Court of Appeal.

The California Superior Court found and the California Court of Appeal affirmed, on the basis of substantial evidence,[6] that respondent's application of worldwide combined reporting to foreign owned multinational groups violated the foreign Commerce Clause because it "impair[ed] federal uniformity in an area where federal uniformity is essential" and "prevent[ed] the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448, 451 (1979) (hereafter the "one voice" test).

Both courts carefully considered, among other authority, *Japan Line*, 441 U.S. 434, *Container*, 463 U.S. 159, and *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986), and applied the dormant Commerce Clause analysis set forth in

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[6]Although there are some stipulations, App. C at 36 and 70, the case was tried on a contested record. The Statement of Decision of the Superior Court (App. C) explains the factual and legal basis for its decision as to each of the controverted issues at trial. Cal. Civ. Proc. Code § 632.

Japan Line and *Container* in reaching their decisions. Both courts rejected the contentions of respondent that five factors, by analogy to *Wardair*, showed a congressional policy "to permit the states to tax as they please" by "negative acquiescence" without congressional legislation.[7] Both courts held that these factors, only one of which even involved worldwide combined reporting,[8] were too general to evidence either the policy urged or congressional acquiescence to such policy. Both courts then tested the application of worldwide combined reporting in this case under the standards of *Japan Line* and *Container*:

- The most obvious foreign policy implication — the threat of offending our trading partners and leading them to retaliate (*Container*, 463 U.S. at 194) — was present.
- Worldwide combined reporting created automatic asymmetry in international taxation in that United States companies did not face worldwide combined reporting abroad.
- The legal incidence of the tax fell on a foreign corporation and its domestic subsidiary.
- The tax burden was more a function of the methodology than the tax rate.

Further the United States had appeared as amicus curiae to inform the courts of foreign policy implications. In light of these

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[7]The factors were: no coverage of state taxes in United States treaties or the United States Model Income Tax Convention, except in nondiscrimination clauses; failure of the Senate to ratify the US/UK Tax Treaty with Article 9(4); failure of Congress to enact legislation restricting state taxes; reservations to the OECD and UN Model Income Tax Conventions; and no coverage of state taxes in treaties of friendship, commerce, and navigation. The Court of Appeal noted that this Court had before it several of the same items in *Container* and still engaged in a dormant Commerce Clause analysis. App. B at 21.

[8]Failure of the Senate to ratify Article 9(4). Neither court could see how the expressed preference of a majority of the Senate to limit state taxes could, in the circumstances, be "transmogrified" into an affirmative policy endorsing such taxes.

distinctions between this case and *Container* and the radical differences between the arm's length international standard and worldwide combined reporting, both courts found that a direct adverse impact on foreign affairs from the use of worldwide combined reporting was "inevitable."[9]

Neither court, like "[this] court in *Container*," App. B at 21, found congressional expression one way or another and the Court of Appeal found a clear and thoroughly grounded policy of the Executive to require the arm's length method to divide income of foreign multinational enterprises. In the face of congressional inertia and inaction and in an area where the Executive has traditionally been given great deference,[10] the policy constituted a "clear federal directive." Thus, worldwide combined reporting in this context also violated the second prong of the *Container* "one voice" test.[11]

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[9]Although the Superior Court found both "definite risk of, as well as actual double taxation" in this case and characterized such double taxation as "more aggravated" in the "foreign multinational context," App. C at 25-26, it ruled worldwide combined reporting in this context did not fail the first additional test of *Japan Line* (double taxation) because double taxation was not "inevitable." The Court of Appeal affirmed.

[10]*See, e.g., United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *Container*, 463 U.S. 159.

[11]The Superior Court also found de facto discrimination amounting to economic protectionism in that foreign based multinationals did not have readily available the necessary financial accountings from many of their foreign subsidiaries (without incurring substantial costs to create an accounting system solely for that purpose) to enable them to comply with worldwide combined reporting and concurrently to take advantage of certain benefits under California tax law. App. C at 26-28. Competitive enterprises not conducting business in other nations do not have this burden. The Superior Court also found that water's edge taxation, which is consistent with the custom of nations in taxing multinational enterprises, was a less intrusive alternative. App. C at 28. The Court of Appeal noted that, while it did not "use costs alone to constitutionally invalidate the use of [worldwide combined reporting] (see *Bibb v.*

The Superior Court also ruled that there was a violation of the due process clauses of the California and United States Constitutions:

> What does constitute a due process violation is the fact that all witnesses agreed that with customarily and currently available accounting data, literal compliance with [worldwide combined reporting] requirements is impossible for foreign multi-nationals such as Plaintiffs, and the only way to "comply" is by supplication and negotiation (absent an unduly burdensome cost of compliance).

App. C at 29. The Court of Appeal did not reach this issue.[12]

(ii) California Supreme Court.

In reversing the decision of the Court of Appeal, the California Supreme Court recognized that it was "presented with a question left open in *Container*, (*supra*, 463 U.S. at p. 189, fns. 26 & 32)," App. A at 3, but rejected analysis under the tests of this Court set forth in *Container* and *Japan Line*. Rather, the California court declared that *Wardair* had "reoriented" the dormant Commerce

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Navajo Freight Lines (1959) 359 U.S. 520, 526 . . .), this legal analysis [of the Superior Court] — based on a factual foundation of substantial evidence — demonstrates just how serious the administrative burden can be for the foreign entity." App. B at 26-27. The Court of Appeal determined on the basis of this evidence that California's allocation method rather than its rate was the primary source of difficulty and that foreign anger was even more understandable "in light of the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations" based on separate accounting. App. B. at 26.

[12]The Court of Appeal stated:

> Having decided that California's application of [worldwide combined reporting] (Rev. & Tax. Code, § 25101) to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal Constitution, it is unnecessary for us to consider the plaintiffs' due process challenge.

App. B at 36-37.

Clause and had reduced the scope for dormant Commerce Clause analysis so as to make such analysis "particularly inappropriate" in this case. App. A at 20. Instead, "*Wardair* supplants what the court has termed the 'quagmire' of dormant commerce clause analysis ([*Northwestern States Portland Cement Co. v. Minnesota*], *supra*, 358 U.S. 450, 458) with a heightened judicial attentiveness to expressions of congressional foreign commerce policy." App. A at 21. From this perspective, the court "abstracted" this Court's analysis of the "textual materials" in *Wardair* "into a kind of protocol for identifying those kinds of governmental silences that give rise to 'negative implications' supporting an inference of federal acquiescence in the state tax under challenge." App. A at 23.[13]

The California court constructed its own test to determine whether a state tax violates the foreign Commerce Clause: whether in the absence of legislation, Congress' "inaction" constituted a "pattern of congressional action" which "evidences both an awareness of [the] issue and a refusal to adopt the remedy urged upon it." App. A at 39. The court took the same five items which the lower courts had rejected as evidences of congressional policy and under its new test treated them as "those kinds of governmental silences . . . [implying] federal acquiescence in the state tax under challenge." App. A at 23.[14]

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[13] For example, the court characterized the failure of treaties to address an international tax problem as to subnational taxes while addressing it as to national taxes as a "congressional policy choice" to permit subnational taxes.

[14] The California Supreme Court did not address the findings of both the lower California courts that there had never been a vote on any congressional legislation and that the bills introduced did not deal solely with the matter at issue. The court also determined that the preliminary votes on Article 9(4) by which a majority of the Senate would have restricted state power were not to be taken as any evidence of intent and that the final vote on the entire Treaty with Article 9(4) reserved was to be considered a "refusal" to curb the state. To overcome the fact that many of the tax treaties and all of the treaties of friendship, commerce, and navigation predated California's extension of worldwide combined

The California court concluded that the "clear federal directive" test in *Container* was not part of the dormant Commerce Clause analysis, but served only to determine whether Congress had acted to preempt an otherwise valid state tax. Thus, the Court of Appeal was incorrect in giving any consideration to executive action in formulating any such directive.

Further, since congressional acquiescence precluded resort to dormant Commerce Clause analysis, the "*Wardair* methodology interdict[ed] judicial resort to executive branch opinions as to the international commercial effect of a challenged state taxation practice . . . ." App. A at 21. Accordingly, the California court rejected the views of the United States, appearing as amicus curiae, that California's use of worldwide combined reporting interfered with the "Federal Executive's conduct of foreign affairs." App. A at 38 n.22.

Thus, the court did not consider the findings below of burden on commerce or the foreign policy implications in the application of worldwide combined reporting, including retaliation and threats of retaliation, but concluded that it was "adher[ing]" to this Court's "central meaning" in *Wardair* in holding that Congress' "refusal to legislate restrictions on state use of worldwide [combined reporting]" was not silence which triggered dormant Commerce Clause analysis. App. A at 39.

The California Supreme Court noted that the Court of Appeal had explicitly declined to decide the due process issue. Stating that "examination of the [due process] issue would profit from a consideration of its merits free of the view that a dormant foreign

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reporting to foreign owned multinational groups, so that failure to cover state taxes might not reflect a "policy choice" to permit this method, the California court assumed that this Court's 1924 decision in *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271 (1924), on the constitutionality of formulary apportionment (but not worldwide combined reporting) and the application of worldwide combined reporting to domestic owned multinationals in the 1960's, evidenced Congress' (and the international community's) awareness of the possibility of worldwide combined reporting as an alternative to the arm's length standard. App. A at 32.

commerce clause analysis is appropriate in the circumstances present here," App. A at 39-40, the court remanded that issue to the Court of Appeal.

REASONS FOR TAKING THE CASE

This Court in *Container* specifically reserved the question in this case, the "constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." 463 U.S. at 189 n.26. Nevertheless, the California Supreme Court, perceiving a "diminution in the reach of dormant foreign commerce clause analysis," App. A at 4, held the very analysis used by this Court in *Container* inapplicable to resolve the question reserved. The California court fashioned a new test in Commerce Clause jurisprudence, permitting a court to disregard "sensitive matters of foreign relations and national sovereignty," *Japan Line*, 441 U.S. at 456, and to search instead for "those kinds of governmental silences that give rise to 'negative implications' supporting an inference of federal acquiescence in the state tax under challenge." App. A at 23. This conclusion is inconsistent with holdings of this Court on the application of the dormant foreign Commerce Clause. *See Japan Line*, 441 U.S. 434; *Container*, 463 U.S. 159. It is also irreconcilable with the decisions of this Court on the need for explicit congressional action to remove state laws which burden commerce from the reach of the Commerce Clause. *See Wyoming v. Oklahoma*, ____U.S.____, 112 S. Ct. 789 (1992); *Maine v. Taylor*, 477 U.S. 131 (1986); *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82 (1984); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982).

The limitation on a state's right to burden commerce is an important and recurring issue before this Court and a number of cases and administrative proceedings in California are dependent on the outcome of this case on this issue. *See* App. G. The decision, if left undisturbed, will stimulate aggressive unconstitutional taxation not just by California but by other states.

The issues presented here are of paramount national importance. The application of this tax method to foreign owned multinational businesses has already led to enactment of retaliatory legislation by the United Kingdom, threats of retaliation, and strong and continuing protests by all of the major trading partners of the United States. In its appearance as amicus curiae in all three California courts below, the United States has attested that the use of worldwide combined reporting in these circumstances is "an egregious interference with the Federal Executive's conduct of foreign affairs and is . . . patently unconstitutional." *See* App. F at 26 n.13.

The decision below erodes United States foreign economic policy by spreading confusion as to how the policy is formulated, confusion as to who speaks for the United States, and even confusion as to what that policy, based on a uniformly accepted international standard to divide income among nations for tax purposes, actually is.

This Court's review of this case is necessary to prevent erosion of federal policy. There are no jurisdictional barriers to review of the foreign Commerce Clause issues. The judgment of the California Supreme Court is final as to these issues, is not subject to further review and is already being applied by California. The foreign Commerce Clause issues are separable from and independent of the due process issue, and too important to be left unreviewed by this Court.

1. CALIFORNIA WORLDWIDE COMBINED REPORTING IS UNCONSTITUTIONAL UNDER THE FOREIGN COMMERCE CLAUSE. THE DECISION BELOW REWRITES ESTABLISHED FOREIGN COMMERCE CLAUSE JURISPRUDENCE AND IS INCONSISTENT AND INCOMPATIBLE WITH THIS COURT'S PRIOR DECISIONS.

Whether state taxes may permissibly burden commerce has been a recurring question before this Court.[15]

This Court has recognized that: "the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate commerce." *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____U.S.____, 112 S. Ct. 2365, ____, 60 U.S.L.W. 4582, 4584 (1992) (citing *Japan Line*, 441 U.S. at 445-46). The reason for the broader protection of foreign commerce is that "matters of concern to the entire Nation are implicated. [*Japan Line*, 441 U.S.] at 448-451." *Kraft*, ____ U.S. at ____, 112 S. Ct. at ____, 60 U.S.L.W. at 4584. Discriminatory treatment of foreign commerce may create problems "such as the potential for international retaliation" that will concern and harm the Nation as a whole. *Id.*[16]

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[15] *See, e.g., Wyoming v. Oklahoma*, ____U.S.____, 112 S. Ct. 789; *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____U.S.____, 112 S. Ct. 2365, 60 U.S.L.W. 4582 (1992); *Container*, 463 U.S. 159; *Japan Line*, 441 U.S. 434.

[16] The same policies underlie the import-export clause. *See Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976) and *Japan Line*, 441 U.S. 434. The broader protection accorded to foreign commerce also requires stricter scrutiny in considering whether Congress has acted to permit such burden. *See South-Central Timber*, 467 U.S. 82.

A. This Court Has Established Criteria for Determining the Constitionality of State Taxes Under the Foreign Commerce Clause; the California Court Disregarded These Criteria.

Japan Line. Recognizing and stressing the need for uniformity in dealing with other nations when foreign commerce is implicated, this Court in *Japan Line* added two additional tests to the basic four part test[17] for determining whether a state tax unconstitutionally burdened commerce:

- whether the tax, notwithstanding apportionment, created a substantial risk of multiple taxation; and

- whether the tax impaired federal uniformity in an area where federal uniformity is essential and prevented the Nation from speaking with one voice when regulating foreign commerce.

Japan Line, 441 U.S. at 451. With respect to multiple taxation, this Court pointed out that "even a slight overlapping of tax — a problem that might be deemed *de minimis* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456. A tax could prevent the Nation from speaking with one voice and frustrate achievement of federal uniformity by leading to international disputes over reconciling apportionment formulae, by creating asymmetry in the international tax structure leading to retaliation which causes harm to the Nation as a whole, not just to the state, and by increasing the potential for varying degrees of multiple taxation should other states follow the taxing state. *Japan Line*, 441 U.S. at 450-51.

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[17]The four part test applicable to all taxes implicating commerce, foreign and domestic, is: (1) the tax must be applied to an activity with a substantial nexus with the taxing state; (2) the tax must be fairly apportioned; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the taxing state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

Container. *Container* involved the same California taxation method at issue here, worldwide combined reporting, but applied to a domestic owned multinational group. In *Container*, this Court reaffirmed the two additional *Japan Line* tests, but found constitutionally significant that double taxation was not an inevitable result of the California taxing scheme and that the tax fell not on foreign owners but on domestic corporations. Elaborating on the "one voice" inquiry, this Court stated that a state tax at variance with federal policy would fail the one voice standard if "it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Container*, 463 U.S. at 194. The most obvious foreign policy implication of a state tax was the "threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.* Recognizing its limited competence in determining precisely when foreign nations would be offended by particular acts, this Court established three "objective standards" in the absence of explicit action by Congress to determine when foreign nations would be offended and to permit the Court to decide how to balance the risk of retaliation against the sovereign right of the United States to let the states tax as they please. The standards reflected general observations about the imperatives of international trade and foreign relations. When applied in the factual context of *Container*, these factors did not lead to the conclusion that the California tax might justifiably lead to foreign retaliation: the tax did not create automatic asymmetry in international taxation; the tax fell not on a foreign entity but on a domestic corporation;[18] and, even if foreign nations had a legitimate interest in reducing tax burdens of domestic corporations, the amount of tax paid by the domestic taxpayer was more a function of the tax rate than the allocation

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[18]This Court also reserved the question of whether its analysis as to the importance of the incidence of the tax might be different if the taxpayer were a domestic subsidiary of a foreign corporation. *Container*, 463 U.S. at 189 n.26.

method. This Court also noted the absence of a brief by the Executive branch.[19]

Tested by these same factors, worldwide combined reporting applied to members of a foreign owned multinational group, as here, is unconstitutional. Worldwide combined reporting clearly implicates foreign policy issues which must be left to the federal government and prevents the Nation from speaking with one voice.[20] This Court need not speculate as to foreign offense: in this case there is actual retaliation as well as threats of retaliation. There is automatic asymmetry in international taxation as United States corporations are not subjected to worldwide combined reporting by any nation. The California tax falls on a foreign corporation as well as on the domestic subsidiary of a foreign corporation. The amount of tax paid is a function of the allocation method, not the tax rate. Finally, the United States has appeared as amicus curiae in all three California courts.

The California Supreme Court never tested worldwide combined reporting by the standards set forth in *Container* and *Japan Line* because it held that changes in this Court's Commerce Clause jurisprudence made such analysis inappropriate.

The California Supreme Court further held that the "clear federal directive" prong of *Container* was not a dormant Com-

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[19]Chief Justice Rehnquist notes in his dissent in *Kraft* that the domestic nature of the petitioner and the absence of a United States amicus brief were the distinctions between *Container* and *Japan Line*. *Kraft*, ___ U.S. at ___, 112 S. Ct. at ___, 60 U.S.L.W. at 4586.

[20]Petitioner contends that worldwide combined reporting applied to taxpayers which are members of a foreign owned multinational group also violates the first additional test, enhanced risk of or actual double taxation. The California Superior Court found actual double taxation and enhanced risk of double taxation in this case but, following *Container*, held that such double taxation was not inevitable. App. C at 25-26. Whether the *Container* requirement of "inevitability" would apply in the circumstances of a taxpayer which is a member of foreign owned multinational business has not been decided and should also be resolved by this Court.

merce Clause test and applied only to invalidate otherwise valid state taxes. It thus avoided the question of whether worldwide combined reporting in these circumstances was fatally inconsistent with federal policy, the more relaxed "species of preemption" standard adopted by this Court in *Container*, 463 U.S. at 194. It also avoided any consideration of the role of the Executive in formulating federal policy on the ground that only Congress played any role in creating such policy.

This Court should affirm that dormant Commerce Clause analysis remains applicable and appropriate, decide the reserved question in *Container*, and give guidance on the scope and application of the "clear federal directive" test.

B. The Decision Below Contradicts the Conclusions of This Court in *Container*.

This Court in *Container* held that failure of treaties to cover subnational taxes or to restrict states to the arm's length method, failure of the Senate to pass the US/UK Treaty with a provision which would have restricted state use of a non-arm's length method, and failure of Congress to enact legislation restricting state taxation did not constitute "specific indications of congressional intent." *Container*, 463 U.S. at 196. The California court determined that these same items constituted evidences of congressional "acquiescence" amounting to ratification of the use of worldwide combined reporting. App. A at 34. If such items evidence a congressional policy sufficient to remove this case from the dormant Commerce Clause, presumably this Court would not have bothered with the balance of its analysis in *Container*. This contradiction illustrates the confusion created by the California court in its search for negative acquiescence. Essentially, the California court is holding that the *Wardair* case, on which it rests its new test, has overruled *Container* sub silentio. This Court should resolve this conflict.

C. The Ruling of the California Court Is Irreconcilable with This Court's Standards for Determining Whether Congress Has Acted To Permit a State To Burden Commerce.

This Court has consistently held that, to exempt a state tax or other regulation which burdens commerce from scrutiny, "Congress must manifest its unambiguous intent before a federal statute will be read to permit or approve of such a violation of the Commerce Clause . . . ." *Wyoming v. Oklahoma*, ___U.S. at ___, 112 S. Ct. at 802. *See also Maine v. Taylor*, 477 U.S. at 139; *South-Central Timber*, 467 U.S. at 91; *Sporhase*, 458 U.S. 941. This Court, in *South-Central Timber*, has further stated that the need for "affirmative approval" of the state statute or regulation is "heightened" when the statute has "substantial ramifications beyond the Nation's borders." 467 U.S. at 92 n.7.[21]

In fact, the "burden [is on the state to] demonstrat[e] a clear and unambiguous intent on behalf of Congress to permit the discrimination against interstate [and foreign] commerce . . . ." *Wyoming v. Oklahoma*, ___U.S. at ___, 112 S. Ct. at 802.

This Court has held that such intent was not demonstrated by reservation to the states of the regulation of local utility rates in the Federal Power Act (*Wyoming v. Oklahoma*), consistency of the state regulation with federal legislation (*South-Central Timber*), deferral by Congress to state law in thirty seven statutes (*Sporhase*), or approval by Congress of several interstate water compacts (*id.*). The congressional enactment must be "an affirmative grant of power to the states to burden . . . commerce 'in a manner which would otherwise not be permissible.' *Southern Pacific Co. v. Arizona ex rel. Sullivan*, [325 U.S. 761,] 769." *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982). These cases presuppose some federal enactment which demonstrates such affirmation. Here there is no such enactment.

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[21]The reason that "congressional authorization not be lightly implied" is the need for a consistent and coherent foreign policy which is the exclusive responsibility of the federal government. *South Central-Timber*, 467 U.S. at 92 n.7.

The California court's approach eliminates the threshold inquiry of burden on commerce and the evidentiary burden on the state to show the "clear and unambiguous intent" of Congress to permit a violation of the Commerce Clause. Rather, the California court would assume a tax valid unless Congress says "no."

The decision below cannot be reconciled with the decisions of this Court on removal of state action from Commerce Clause scrutiny. The decision is an invitation to state taxation unrestrained by constitutional limitations.

D. The Decision Below Is Inconsistent with This Court's *Wardair* Decision.

Wardair concerned a state sales tax on a discrete transaction (purchase of fuel in Florida) occurring only within one national jurisdiction. The case had neither actual nor possible international multiple taxation. After strongly reaffirming the policies of the dormant Commerce Clause, this Court determined that the federal policy urged by the petitioner, reciprocal tax exemptions for aircraft, did not exist. On the contrary, "in the context of this case," the evidence demonstrated that the federal government had "affirmatively acted, rather than remained silent, with respect to the power of the state to tax aviation fuel." *Wardair*, 477 U.S. at 9. This Court found congressional action constituting law in the Chicago Convention, a treaty entered into by the United States and 156 other nations, which by its terms precluded the imposition of local taxes on fuel in certain circumstances but did not prohibit the taxation of fuel in the circumstances before the Court. This text demonstrated:

> the international community's awareness of the problem of state and local taxation of international air travel, specifically aviation fuel, and represent[ed] a decision by the parties to that Convention to address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority.

Wardair, 477 U.S. at 10. Subsequent treaties, including the United States/Canadian Treaty,[22] dealt only with national taxes, leading to the inference that Congress had "negatively acquiesced" in the Florida tax.

This Court explicitly said not only that it was not addressing, but also that "nothing in this opinion should be understood to address, whether, in the absence of these international agreements, the Foreign Commerce Clause would invalidate Florida's tax." *Wardair*, 477 U.S. at 13. Nevertheless, the California court seized on the decision as heralding a change in this Court's dormant foreign Commerce Clause jurisprudence. The California court's new test, congressional "refusal" to act while aware of the problem, does not appear in *Wardair*.[23] This Court proceeded in *Wardair* against an extensive background of enacted congressional legislation — the Federal Aviation Act domestically and the Chicago Convention internationally — both of which dealt with state sales taxes and the latter with state sales taxes on aviation fuel. Here there is no seminal statute or other enactment which addresses the specific problem.

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[22]The Canadian provinces also were applying a tax similar to that imposed by Florida, an indication that there was no uniform policy against such taxes.

[23]Other than Article 9(4) of the US/UK Treaty, none of the items which the court below used as evidence of awareness and refusal even deals with worldwide combined reporting applied to foreign multinational groups. Under the California court's approach, the stalemate created by the minority in the Senate over Article 9(4) becomes an explicit "refusal" to act evidencing Congress' exercise of its "power . . . [t]o regulate Commerce with foreign Nations . . . ." U.S. Const. art. I, § 8, cl. 3.

2. THE DECISION BELOW UNDERMINES ESSENTIAL CONSTITUTIONAL RESTRAINTS ON STATE POWER TO INTERFERE IN THE CONDUCT OF FOREIGN POLICY, AND, IF LEFT UNDISTURBED, THREATENS SERIOUS HARM TO THE NATION.

The decision below has implications far beyond the question of constitutionality of worldwide combined reporting as applied herein. The California court proceeds on the assumption that *Wardair* presages a diminution in the reach of the dormant foreign Commerce Clause.[24] Although it recognized that foreign governments objected strenuously to the practice of worldwide combined reporting and that "executive branch officials charged with conducting American foreign commercial policy agree[d] with them," App. A at 37 n.21, the California court used the alleged diminution as its predicate for ignoring both the United States and the foreign governments. Given the importance of foreign Commerce Clause jurisprudence, which concerns "sensitive matters of foreign relations and national sovereignty," *Japan Line*, 441 U.S. at 456, this Court should clarify that there is no such diminution.

The California court's substitute test, if left to stand, would lead to serious harm to the Nation. A recurring theme in this Court's decisions on foreign commerce issues is concern over harm to the nation as a whole from state actions which may lead to retaliation. *Japan Line*, 441 U.S. 434; *Container*, 463 U.S. 159; *Kraft*, ___ U.S. ___, 112 S. Ct. 2365, 60 U.S.L.W. 4582; *Chy Lung v. Freeman*, 92 U.S. 275 (1875). These decisions recognize that all nations have a proper concern for the well being of their nationals, that nations do not take these concerns lightly, that response is a national, not a state, responsibility and that states have no role in the process. *Hines v. Davidowitz*, 312 U.S. 52

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[24]The California court refers to this Court's "recent foreign Commerce Clause jurisprudence" but relies only upon *Wardair*. The decision below was issued prior to *Kraft*, ___ U.S. ___, 112 S. Ct. 2365, 60 U.S.L.W. 4582.

(1941); *Zschernig v. Miller*, 389 U.S. 429 (1968); *Japan Line*, 441 U.S. 434.

The decision below, however, trivializes nation-to-nation initiatives to resolve conflicts, including such efforts as those in this case to have the states voluntarily cease use of the apportionment method.[25] Patience by nations is viewed by the California court as further evidence of congressional acquiescence. If any test is destined to lead to retaliation by foreign governments, it is the California court's new test.

The decision of the court below, if left unreviewed, would emasculate the Federal Executive in foreign affairs any time a state chose to interfere and Congress did not enact legislation curbing the state. The "one voice" test proceeds from the strong presumption of the need for federal uniformity in the area of foreign commerce. *Japan Line*, 441 U.S. 434; *Wardair*, 477 U.S. 1. However, the California court would silence the Executive[26] and in the silence of Congress permit a cacophony of state voices. How are our foreign trading partners to discern the foreign policy of the United States if there is no text? Who can tell our foreign trading partners what that policy is? Can our foreign trading partners rely upon the responses of the Executive? Is this not exactly the situation which will lead to retaliation and harm to the nation as whole?

The issue is even more serious since it is the United States that has been the leader in establishing the international standard. The

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[25]The California court calls the results of such efforts "meliorative measures designed to pacify critics," App. A at 36, a clear invitation to the states to revoke such "measures" when they tire of "pacification."

[26]The Federal Executive has substantial power in the area of foreign affairs. *Curtiss-Wright Export*, 299 U.S. 304; *United States v. Pink*, 315 U.S. 203 (1942); *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579 (1952). In the absence of congressional action, executive action, particularly, as here, against a backdrop of enacted national policy designed specifically to deal with international division of income, is entitled to great weight. *Youngstown Sheet*, 343 U.S. 579; *Dames & Moore v. Regan*, 453 U.S. 654 (1981).

standard forwards the long established and overarching United States foreign economic policy to open markets and remove barriers to trade. United States business benefits from this standardization. Other nations will not long tolerate increased taxes on their nationals from this aberrant system, increased burdens of compliance arising from the requirement of their nationals to respond to two separate systems to divide and report their international income among competing jurisdictions, and possible impact on their fiscs without retaliating against American business.[27]

If a state of the United States which is economically the equivalent to the seventh or eighth largest nation in the world is permitted to promote its incompatible and inconsistent tax system, how can the United States seek the cooperation of its trading partners in adhering to the international standard.

3. THIS COURT'S REVIEW IS ESSENTIAL TO PREVENT EROSION OF IMPORTANT FEDERAL POLICIES; THERE ARE NO JURISDICTIONAL BARRIERS TO REVIEW OF THIS CASE.

California's use of worldwide combined reporting in these circumstances is undermining the federal economic policy of promoting a uniform standard for division of income for tax purposes between nations. In addition to removing trade barriers, the federal policy promotes the management of conflict and the mitigation of double taxation, and encourages American trade and competitiveness. Left unreviewed, the judgment of the California court, by perpetuating and encouraging worldwide combined reporting, or any other aberrant method of dividing international income, will continue the erosion of this important federal policy. Moreover, the California court's judgment introduces new confusion into Commerce Clause jurisprudence, and draws into question this Court's settled policy of exhibiting greater sensitivity in matters of international concern. *See Japan Line*, 441 U.S. at 448-51; *Kraft*, ___ U.S. at ___, 112 S. Ct. at ___, 60 U.S.L.W. at 4584. It would be "intolerable to leave unanswered" this important constitutional question with national

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[27]The United Kingdom already has.

and international implications. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 484-85 (1975) (quoting *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 247 n.6 (1974)).

No jurisdictional barriers to this Court's review of this case exist. The judgment of the California Supreme Court, that worldwide combined reporting did not violate the foreign Commerce Clause when applied to apportion the income of foreign-owned multinational business, meets the criteria established by this Court for finality under 28 U.S.C. § 1257 where further state proceedings may occur. *Cox*, 420 U.S. at 476-87. The judgment is of the highest California court, is not subject to further review in California and is binding on all lower California courts.

That the further state proceedings may involve a federal question (i.e., the due process issue) is not determinative. This Court has shown a willingness to hear cases with unresolved federal issues in certain circumstances. *Hudson Distribs., Inc. v. Eli Lilly & Co.*, 377 U.S. 386 (1964); *see also Flynt v. Ohio*, 451 U.S. 619 (1981). The circumstances of this case warrant immediate review of the foreign Commerce Clause issues. These issues are separable from the issue remanded and will not be affected by any proceedings on the remand.[28] The foreign Commerce Clause issues are "too important to be denied review and too independent [of the remanded issue] to require that appellate consideration be deferred until the whole case is adjudicated." *Cohen v. Beneficial Indus. Loan Corp.*, 337 U.S. 541, 546 (1949). A favorable decision by this Court on the issue decided by the California Supreme Court will dispose both of this and of other pending litigation.[29] On the other hand, if this Court were to deny review

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[28]Unlike the eminent domain cases discussed in *Cox*, 420 U.S. at 477-78 n.6, where the two federal questions are part of an integral problem, the due process issue is not integral to or any part of the foreign Commerce Clause issues.

[29]That a decision in petitioner's favor on the foreign Commerce Clause issues will dispose of the case is shown by the fact that the California Court of Appeal found it unnecessary to reach the due process issue after ruling in petitioner's favor on the issues presented

and if petitioner were to prevail below, the foreign Commerce Clause issues may be mooted and these important questions would not reach this Court. *See Cox*, 420 U.S. at 482-83.

This Court has stated on numerous occasions that the rule of finality is to be given a practical rather than a technical interpretation. *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 152-53 (1964); *Cohen*, 377 U.S. at 546. In making this practical determination, this Court has stated that where "refusal immediately to review the state-court decision might seriously erode federal policy, [this] Court has entertained and decided the federal issue, which itself has been finally determined by the state courts for purposes of the state litigation." *Cox*, 420 U.S. at 483. The policies at stake here surely merit this Court's attention.

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here. In addition, a number of cases await the outcome of this case, but only on the foreign commerce "one voice" issue. Respondent required waiver of all issues except the "one voice" issue in cases seeking a deferral. *See* App. G.

CONCLUSION

This Court has established a framework for analysis of state taxes which may burden foreign commerce. The California court has not only jettisoned the analytical framework created by this Court in *Japan Line* and *Container*, it has essentially embraced an approach which this Court has rejected many times, namely that the states are free to tax until Congress tells them to stop. *See, e.g., Japan Line*, 441 U.S. at 454-55; *Southern Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 769 (1945). The decision below cannot be reconciled to the principles established by this Court and it carries grave dangers of harm to the Nation. For the foregoing reasons this Court should grant this petition for Writ of Certiorari.

Respectfully submitted,

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No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

vs.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

APPENDICES TO PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

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APPENDIX A

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL, LTD.,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

BARCLAYS BANK OF CALIFORNIA,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

S019064
Ct. App. No. C003388
Sacto. Super. Ct.
Nos. 325059 and 352061

Supreme Court Filed May 11, 1992

Robert Wandruff Clerk
DEPUTY

We granted review to decide whether the use by the state Franchise Tax Board of a three-factor formula to apportion the income of a foreign-parent multicorporate unitary enterprise for state tax purposes violates the foreign commerce clause of the federal Constitution (art. I, § 8, cl. 3). We conclude that relevant treaty and other materials manifest a federal intent not to prohibit the states from employing formula apportionment in taxing the income of such a multinational unitary business. We therefore reverse the judgment of the Court of Appeal.

I

Plaintiff taxpayers, Barclays Bank of California and Barclays Bank International, Ltd. (collectively, the Bank), brought this refund action to recover assessments of $152,420 and $1,678 levied against them by the Franchise Tax Board (Board) for the 1977 tax year. The basis for the assessments was a finding by the Board that, together with their United Kingdom-based corporate parent and related worldwide subsidiaries, the Bank comprised a unitary enterprise, thereby subjecting it to the three-factor mathematical formula used by the Board to apportion the interjurisdictional income of a unitary business for state corporate income tax purposes.[1] Although the Bank did not contest the Board's predicate finding of corporate unity, it did claim that application of California's apportionment formula to such a unitary group — that is, one whose corporate parent is a foreign domiciliary — violates the foreign commerce clause of the federal Constitution.

Following a bench trial, the superior court ruled in favor of the Bank; the Court of Appeal affirmed, holding that California's

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[1]During 1977, the tax year at issue here, Revenue and Taxation Code section 25101 provided in relevant part: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); . . ."

Section 25120 et seq. of the Revenue and Taxation Code is California's version of the Uniform Division of Income for Tax Purposes Act (UDITPA; see 7A West's U. Laws Ann. (1985) p. 331); as explained more fully later in this opinion, the statute authorizes the use of a three-factor formula to apportion the net income from a taxpayer's total business activities in order to determine the net income attributable to intrastate activities. (See *post*, p. ___ et seq. [typed maj. opn. p. 5 et seq.]; Rev. & Tax. Code, §§ 25120-25140.)

In this opinion, we sometimes use the term "formula apportionment" as a shorthand description of this three-factor mathematical formula employed by the Board to apportion for state tax purposes the interjurisdictional income of a worldwide or domestic unitary enterprise.

formula apportionment method was unconstitutional as applied to foreign-based unitary groups. In the view of the Court of Appeal, use of the Board's method in such a case violated the foreign commerce clause in two respects. First, its application to a so-called "foreign parent" unitary business implicated foreign policy issues that were constitutionally required to be left to the federal government. Second, use of the formula apportionment method in the Bank's case was at odds with a clear federal directive embodied in presidential and cabinet-level statements, letters, and press releases, task force reports and the congressional testimony of senior executive officials to the effect that American foreign commercial policy supported the use of an alternative accounting method to determine the taxable income of foreign-based corporations, one that is incompatible with formula apportionment.

As the Court of Appeal recognized, this suit is not the first litigation challenging on foreign commerce clause grounds the Board's use of a three-factor formula to apportion the worldwide income of a multinational enterprise. In *Container Corp. v. Franchise Tax Bd.* (1983) 463 U.S. 159 (*Container*), the United States Supreme Court sustained against foreign commerce clause challenge the Board's use of formula apportionment to determine the taxable income of a *domestic*-based unitary business group with foreign-domiciled subsidiaries. Despite the outcome in *Container*, the Bank successfully contended before the Court of Appeal that issues implicated by its foreign parentage are dispositive of the constitutional question and compel the opposite result in this case.

Although presented with a question left open in *Container* (*supra*, 463 U.S. at p. 189, fns. 26 & 32), we approach its resolution along a path illuminated by the high court's analysis in a series of recent opinions, *Container* among them, in the contemporary evolution of the "dormant foreign commerce clause" doctrine. Our opinion has two parts. As a prelude to the constitutional question, we first examine the extralegal issues raised by competing methodologies used to distribute multijurisdictional corporate income for state tax purposes; we then address the Bank's central contention that a dormant foreign commerce clause analysis is appropriate here and that the Board's applica-

tion of formula apportionment to the Bank's unitary business does not survive that analysis.

As we explain, neither of the two competing models used to allocate interjurisdictional income for state tax purposes is demonstrably superior to the other, even in an international multicorporate setting. Both methods meet the constitutional standard of avoiding "unreasonably" attributing extrastate value to the taxing jurisdiction. Moreover, the high court's recent foreign commerce clause jurisprudence reflects a diminution in the reach of dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, governmental silence may constitute a ratification of state taxation of foreign commerce, rendering a dormant analysis inapposite. In our view, this is such a case.

II

Background: State Taxation of International Income

A

Limitations on taxation by the states of the income of corporations doing business in more than one jurisdiction inevitably implicate the sufficiency of quantitative measures used to identify that portion of taxable value reasonably attributable to the taxpayer's intrastate activities. This pivotal role of technique arises from the stricture of the commerce and due process clauses of the federal Constitution that "a State may not tax value earned outside its borders." (*ASARCO Inc. v. Idaho State Tax Comm'n* (1982) 458 U.S. 307, 315 (*ASARCO*).) To meet this limitation, state tax schemes must comply with multiple criteria designed to produce a substantially accurate distribution of income so that only "values created by business within its borders" are taxed. (*Butler Bros. v. McColgan* (1942) 315 U.S. 502, 507 (*Butler Bros.*).)

Two distinct models have long competed for supremacy in identifying the required division of multijurisdictional income. One model, known as the "arm's length/separate accounting" or "AL/SA" method, calculates income on a discrete and circum-

scribed basis, whether geographical, transactional, or functional. In a multicorporate interjurisdictional setting, the AL/SA method allocates income to a single taxing "sovereign" rather than apportioning it among jurisdictions, and treats intercorporate transfers of value between commonly held or related entities as if they were "arm's length" transactions between unaffiliated businesses. There seems little reason to doubt that, as an operational matter, the AL/SA model is the dominant method employed by corporations both in the United States and internationally; that is, a majority of businesses use the AL/SA or a variant method for their *own* internal accounting purposes.

The competing model for taxation purposes is the "unitary business/formula apportionment" method. Founded on the perception that "[i]n the case of a more-or-less integrated business enterprise operating in more than one State . . . arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice" (*Container, supra*, 463 U.S. at p. 164), formula apportionment relies on mathematical generalization to distribute an aliquot share of income or taxable value among taxing jurisdictions. The dominant variation of formula apportionment — the so-called "three-factor" model employed by the Board in this case — defines the multijurisdictional scope of the unitary enterprise of which the taxable intrastate activities are a part, calculates the combined income of the components of the unitary group, and distributes a portion of that result to the taxing state using a mathematical formula based on an averaged ratio of property, payroll, and sales in the taxing jurisdiction to that of the unitary enterprise overall.[2] (See *Container, supra*, 463 U.S. at p. 165.)

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[2]Thus, the taxable income of a multijurisdictional unitary taxpayer in a state using the three-factor variant of formula apportionment would be calculated under the following equation:

$$\frac{\frac{\text{In-state Property}}{\text{Total Property}} + \frac{\text{In-state Payroll}}{\text{Total Payroll}} + \frac{\text{In-state Sales}}{\text{Total Sales}}}{3} \times \text{Total Corporate Income} = \text{Income Taxable by the state}$$

So far as taxation of United States-derived income is concerned, the use of formula apportionment is both established and noncontroversial, being the preferred method of a majority of the states; a substantially smaller number of American jurisdictions — California among them — combine and apportion the *worldwide* income of multinational corporate taxpayers, a variant sometimes referred to as the "worldwide combined reporting" or "WWCR" method.[3]

Although AL/SA is the method of choice for corporate operational and internal accounting purposes, its recognized deficiencies in purporting to locate and assign taxable value to a particular jurisdiction reduce its appeal among state tax administrators, the chief proponents of competing apportionment methods. These critics cite several shortcomings in the AL/SA method: comparative distortions in measuring income, and a resulting overtaxation or undertaxation; administrative complexity generated by the need to analyze thousands of intercorporate transactions; and the common absence of uncontrolled comparable prices by which to verify the value of intercorporate "arm's length" transactions.[4]

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[3](See *Moorman Mfg. Co.* v. *Bair* (1978) 437 U.S. 267, 283, fn. 1 (Powell, J., dis.) [45 of 50 states use some form of income apportionment]; *Trinova Corp. v. Michigan Dept. of Treasury* (1991) ___ U.S. ___ , ___ [111 S.Ct. 818, 831-832]; see also Chairman's Rep. and Supplemental Views, Final Rep. of the Worldwide Unitary Taxation Working Group (Aug. 1984) (hereafter Chairman's Report) p. 1 [all 45 states that levy a corporate income tax use formula apportionment to distribute taxable income of single multijurisdictional corporations]; U.S. General Accounting Office, Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving (July 1, 1982) GAO/GGD-82-38 (hereafter GAO Report), at appen. II, pp. 58-67 [tabular breakdown in use of apportionment variants among the states].)

[4]The critical literature assessing both methods is extensive. (For a sampling, see Chairman's Rep., *supra*; GAO Rep., *supra*; Note, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Colum. J. Transnat'l L. 445; Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa

More fundamentally, critics of the AL/SA method have pointed to a theoretical failure of the model to account for income created by the effects of unitary interdependency. As the high court has stated in the case of a unitary business enterprise, "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. [Citation.] Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'" (*Mobil Oil Corp. v. Commissioner of Taxes* (1980) 445 U.S. 425, 438 (*Mobil Oil*).)

Of course, formula apportionment has its critics, as well. They too point to distortions in the measurement of taxable income, especially in a multinational setting where a relatively larger proportion of foreign to United States activities may result in overtaxation of the income of foreign-based unitary businesses; the substantial administrative burden of complying with income reporting requirements in United States dollars and accessing financial information that in some cases may be in the hands of literally hundreds of worldwide corporate affiliates; and the absence of uniform standards among the states for defining a unitary

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Clara L.Rev. 123; Rudy, *The California Unitary Tax Concept as Applied to the Worldwide Activities of Foreign Corporations: A Modern Commerce Clause Analysis* (1980-81) 15 U.S.F. L.Rev. 371; Note, *Multinational Corporations and Income Allocation under Section 482 of the Internal Revenue Code* (1975-1976) 89 Harv.L.Rev. 1202; Hellerstein, *State Income Taxation of Multijurisdictional Corporations: Reflections on Mobil, Exxon, and H.R. 5076* (1978) 79 Mich. L.Rev. 113; Hellerstein, *State Income Taxation of Multijurisdictional Corporations, Part II: Reflections on ASARCO and Woolworth* (1982) 81 Mich. L.Rev. 157; Hellerstein, *State Taxation Under the Commerce Clause: An Historical Perspective* (1976) 29 Vand. L.Rev. 335; Corrigan, *Interstate Corporate Income Taxation — Recent Revolutions and a Modern Response* (1976) 29 Vand. L.Rev. 423; Langbein, *The Unitary Method and the Myth of Arm's Length* (1986) 30 Tax Notes 625; see also Hearings Before the House Com. on Ways and Means on H.R. No. 5076, 96th Cong., 2d Sess. (1980).)

business.[5] Not surprisingly, partisans on both sides of the issue contend that their method is the accepted standard — in the international arena in the case of AL/SA, and in the taxation of multijurisdictional unitary groups in the case of formula apportionment.[6]

B

The United States Supreme Court first considered the sufficiency of formula apportionment in the constitutional sense over 70 years ago, upholding Connecticut's use of a single-factor formula to apportion the income of a Connecticut business machine manufacturer whose products were marketed nationally. The high court rejected the taxpayer's due process claim that the formula taxed business conducted "beyond the boundaries of the State." As the Supreme Court explained, "[t]he profits of the [company are] largely earned by a series of transactions beginning with manufacture in Connecticut and ending with the sale in other states. . . . The legislature in attempting to put on this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." (*Underwood Typewriter Co. v. Chamberlain* (1920) 254 U.S. 113, 120-121 (*Underwood*).)

Since *Underwood, supra*, 254 U.S. 113, the Supreme Court has confronted recurrent claims of the comparative superiority of each of these two theoretically irreconcilable techniques in responding to the distributive imperatives of the commerce clause. Despite claims of the surpassing merit of the separate accounting method, the court has refused to erect a "theoretical constitutional preference for one method of taxation over another" by mandating its use. (*Mobil Oil, supra*, 445 U.S. at p. 444.)

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[5](See, e.g., Chairman's Rep., *supra*, at pp. 1-8; GAO Rep., *supra*, at pp. 32-40; and materials cited *ante*, at fn. 4.)

[6]The trial court found as a matter of fact that the AL/SA method was the "international standard of accounting" and that "[n]o other system is used internationally."

Likewise, it has rejected appeals to prescribe a variant of the formula apportionment method as a uniform national standard for interstate taxation. (*Moorman Mfg. Co. v. Bair, supra*, 437 U.S. 267, 278 (*Moorman*).)

Although the high court has refused to impose "national uniform rules for the division of income" rooted in the commerce clause (*Moorman, supra*, 437 U.S. at p. 279), it has repeatedly validated the comparative empirical accuracy and constitutional adequacy of formula apportionment. Thus, not long after upholding the due process sufficiency of formula apportionment in *Underwood, supra*, 254 U.S. 113, the court authorized its use in a multinational setting to apportion the combined income of a United Kingdom-headquartered brewer whose separate accounting showed no United States net income for the tax years at issue. Contending that the state was in effect taxing foreign income, the taxpayer asserted violations of the foreign commerce and due process clauses. (*Bass, Etc., Ltd. v. Tax Comm.* (1924) 266 U.S 271 (*Bass*).)

The high court rejected the challenge. The taxpayer's business, the court explained, was a unitary enterprise conducted transnationally, "in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places — the process of manufacturing resulting in no profits until it ends in sales. . . ." The state was thus justified "in attributing to [itself] a just proportion of the profits earned by the Company from such [a] unitary business." Moreover, since the taxpayer had failed, as in *Underwood, supra*, 254 U.S. 113, to show that formula apportionment "produced an unreasonable result," its use was not unconstitutional. (*Bass, supra*, 266 U.S. at pp. 282, 283.)

In *Butler Bros., supra*, 315 U.S. 502, the taxpayer also challenged the state's use of formula apportionment on the ground that separate accounting showed its sales office in the taxing jurisdiction had no net income for the tax year at issue and that apportionment thus resulted in the taxation of extraterritorial value. The court rejected this showing as insufficient, explaining that it "need not impeach the integrity of [the separate] accounting system to say that it does not prove [taxpayer's] assertion that

extraterritorial values are being taxed. . . . A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders." (*Id.*, at p. 507.)

And in *Exxon Corp. v. Wisconsin Dept. of Revenue* (1980) 447 U.S. 207, the court rejected the attempt of a vertically integrated, multistate petroleum company to demonstrate, based on its internal use of the separate accounting method applied to distinct operating divisions, that income was allocable to extrastate components and thus constitutionally was not subject to apportionment. "[A] company's internal accounting techniques are not binding on a State for tax purposes," the court wrote. "Exxon's use of separate functional accounting . . . does not defeat the clear and sufficient nexus between [its] interstate activities and the taxing State" upon which the finding of corporate unity was based. [*Id.*, at pp. 221, 225.)

Again, in *Mobil Oil, supra*, 445 U.S. 425, a nondomiciliary corporate taxpayer challenged the state's inclusion in its apportionment formula of foreign source dividend income received by the taxpayer from subsidiaries and affiliates, on the ground that its foreign origin made it constitutionally unapportionable. Although the taxpayer was able to isolate its foreign dividend income using separate accounting, the court observed that "the linchpin of apportionability in the field of state income taxation is the unitary business principle." (*Id.*, at p. 439.) The divisibility of income produced by a separate accounting treatment, the court said, "may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale . . . . Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required." (*Id.*, at p. 438.) (See also *ASARCO, supra*, 458 U.S. 307; *F. W. Woolworth Co. v. Taxation & Revenue Dept.* (1982) 458 U.S. 354; and *Amerada Hess Corp. v. N. J. Taxation Div.* (1989) 490 U.S. 66, 74.)

In a slightly different context, the high court recently reaffirmed its views of both the theoretical problems inherent in locating the "source" of multijurisdictional income, and the validity for commerce clause purposes of the formula apportion-

ment method. Last term, in upholding Michigan's "value added" tax against commerce clause challenge, the court wrote that "the discrete components of a state income tax may appear in isolation susceptible of geographic designation. Nevertheless, since *Underwood* . . . we have recognized the impracticability of assuming that all income can be assigned to a single source." (*Trinova Corp. v. Michigan Dept. of Treasury, supra*, ____ U.S. ____, ____ [111 S.Ct. 818, 831].)

The court went on to reiterate its statement in *Container, supra*, 463 U.S. at page 170, that the three-factor formula "has become something of a benchmark against which other apportionment formulas are judged," noted its incorporation into UDITPA, adopted by almost half of the states, and acknowledged its accuracy in reflecting "the activities by which [taxable] value is generated." "The same factors," the court wrote, "that prevent determination of the geographic location where income is generated, factors such as functional integration, centralization of management, and economies of scale, make it impossible to determine the location of value added with exact precision." (*Trinova Corp. v. Michigan Dept. of Treasury, supra*, ____ U.S. ____ [111 S.Ct. at p. 832].)

Thus, the rule that has emerged from this series of high court encounters — spanning over 70 years — with the contending merits of two "theoretically incommensurate" systems (*Mobil Oil, supra*, 445 U.S. at p. 444) is that, for state tax purposes, neither the commerce clause nor the due process clause of the federal Constitution mandates the use of a particular methodology to allocate or distribute multijurisdictional income. Either of the two principal methods and their variants is constitutionally permissible, as long as the one chosen does not operate "unreasonably and arbitrarily" to attribute to the taxing state a percentage of total income "out of all appropriate proportion to the business transacted by the [taxpayer] in that State." (*Hans Rees' Sons v. No. Carolina* (1931) 283 U.S. 123, 135.) Or, as the high court stated in *Moorman, supra*, 437 U.S. 267, 274, "the States have wide latitude in the selection of apportionment formulas and . . . a formula-produced assessment will only be disturbed when the taxpayer has proved by clear and cogent evidence that the income

attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that State." (Internal quotation marks omitted.)

We present this extended account of the competing division-of-income methods and their treatment at the hands of the high court in order to meet at the outset the Bank's unpersuasive contention that formula apportionment is an inherently inequitable method, at least when applied to foreign-based unitary groups such as the Bank and its affiliates.[7] In substance, this argument is no different from the one explicitly rejected by the court in *Container, supra*, 463 U.S. 159. There the taxpayer presented related challenges to California's use of the three-factor formula to apportion the global income of a domestic-based unitary enterprise. Specifically, the taxpayer claimed that its foreign affiliates were significantly more profitable, and that by ignoring underlying economic realities such as lower wage and production costs among its foreign subsidiaries, three-factor formula apportionment systematically distorted the "true" allocation of income between unitary components, unfairly inflating the income apportioned to California.

"The problem with this argument," the court said, "is . . . [that] the profit figures relied on by [the taxpayer] are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resort to formula apportionment in the first place." And the difficulty with the taxpayer's evidence of differing costs, the court said, "is that it does not by itself come

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[7]To forestall any conceptual misunderstanding, we note that one of the two elements of the dormant foreign commerce clause analysis developed by the high court in *Japan Line, Ltd. v. County of Los Angeles* (1979) 441 U.S. 434 and subsequent cases (see *post*, p. ___ et seq. [typed maj. opn. p. 19 et seq.]) is the risk of multiple taxation posed by the challenged state taxation method. Although the high court's assessment of the principal division of income methods speaks to that risk, the foregoing summary is undertaken for the limited purpose of gauging the comparative technical or "accounting" merits of the two models, not as part of a dormant commerce clause analysis. (See *post*, p. ___ et seq. [typed maj. opn. p. 33 et seq.].)

close to impeaching the basic rationale behind the three-factor formula. . . . [¶] Both geographical accounting and formula apportionment are imperfect proxies for an ideal which is not only difficult to achieve in practice, but also difficult to describe in theory. . . . " (*Container, supra*, 463 U.S. at p. 182.) "Of course, even the three-factor formula is necessarily imperfect," the court continued, "[b]ut we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by [taxpayer]." (*Id.*, at pp. 183-184.)

In light of this analysis and the precedents summarized above, we conclude that, in considering the Bank's case for relief, neither of the two methods can lay claim to a decisive technical superiority or greater constitutional stature than the other.[8] We turn, then, to the merits of the Bank's contention that a dormant foreign commerce clause analysis renders unconstitutional the Board's application of the three-factor apportionment formula to the Bank's unitary enterprise.

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[8]The Bank argues that the conclusion in the *Container* opinion (*supra*, 463 U.S. at p. 184) that three-factor formula apportionment is a "proper and fair method of taxation" does not mean that its application to foreign-based multinationals produces an accurate determination of their intrastate income. The *Container* characterizations, the Bank contends, are merely the outcome of the four-part dormant interstate commerce clause analysis developed in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274. This argument strikes us as semantical at best.

The court made clear in *Trinova Corp. v. Michigan Dept. of Treasury, supra,* ____ U.S. ____ [111 S.Ct. 881, 835], that if a state tax complies with the requirement of fair apportionment, constitutional demands are exhausted. Moreover, even under a dormant foreign commerce clause analysis, both the trial court and the Court of Appeal concluded — largely under the compulsion of the identical holding in *Container, supra,* 463 U.S. 159 — that the Board's use of worldwide formula apportionment in this case did not offend the risk-of-multiple-taxation leg of the dormant analysis.

III

The Dormant Foreign Commerce Clause Doctrine

Despite the framers' explicit commitment to Congress of the power to "regulate commerce with foreign nations, and among the several states" (U.S. Const., art. I, § 8, cl. 3), by far the bulk of commerce clause jurisprudence has been developed by the high court itself under the judicially created doctrine of the "unexercised," "negative," or "dormant" commerce clause. From its origin early in the nation's constitutional history with the opinion of Chief Justice Marshall in *Gibbons v. Ogden* (1824) 22 U.S. (9 Wheat.) 1, 209, through its reformulation at the hands of Justice Curtis in *Cooley v. Board of Wardens of Port of Philadelphia et al.* (1852) 53 U.S. (12 How.) 298, the high court has posited irreducible and self-executing constitutional minima that limit state action affecting interstate and foreign commerce, even where Congress has *failed* to exert its plenary commerce clause power. "[T]he Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. In short, the Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States. . . ." (*Freeman v. Hewit* (1946) 329 U.S. 249, 252; see also *Southern Pacific Co. v. Arizona* (1945) 325 U.S. 761, 769 ["For a hundred years it has been accepted constitutional doctrine that the commerce clause, without the aid of Congressional legislation . . . affords some protection from state legislation inimical to the national commerce, and that in such cases, where Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter of the competing demands of state and national interests. [Citations.]"]; *Hood & Sons v. Du Mond* (1949) 336 U.S. 525, 534; *Northwestern Cement Co. v. Minn.* (1959) 358 U.S. 450, 458; *Hughes v. Oklahoma* (1979) 441 U.S. 322, 326, fns. 2 & 3; *Wyoming v. Oklahoma* (Jan. 22, 1992) ____ S.Ct. ____, ____ [60 U.S.L. Week 4119, 4124].)

In the modern era, the consolidative work of the court led it to recast the interstate dimension of the dormant commerce clause doctrine as it applies to state taxation. In *Complete Auto Transit,*

Inc. v. Brady, supra, 430 U.S. 274, the court adopted a four-part test to evaluate state tax schemes to ensure compliance with the inherent demands of the "unexercised" commerce clause. If a tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State," it does not burden impermissibly interstate commerce. (*Id.*, at p. 279.)

This four-part test is not adequate, however, to subserve the additional policies underlying the foreign commerce clause. In *Japan Line, Ltd. v. County of Los Angeles, supra*, 441 U.S. 434 *(Japan Line)*, the court held that "[w]hen construing Congress' power to 'regulate Commerce with foreign Nations,' a more extensive constitutional inquiry is required." (*Id.*, at p. 446.) Specifically, "two additional considerations, beyond those articulated in *Complete Auto*, come into play." *(Ibid.)* "In addition to answering the nexus, apportionment, and nondiscrimination questions posed in *Complete Auto*, a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international *multiple taxation*, and second, whether the tax prevents the Federal Government from 'speaking with *one voice* when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts, it is unconstitutional under the [foreign] Commerce Clause." (*Id.*, at p. 451, emphasis added.)

Although the court's opinion in *Japan Line, supra*, 441 U.S. 434, stressed the paramount national need for and plenary nature of congressional power over foreign commerce — greater, perhaps, than Congress's textually parallel power over interstate commerce (*id.*, at p. 448 & fns. 12-13) — as one of the fundamental policies animating the framers, it had little to say concerning the preemptive role of Congress in defining the contours of permissible state taxation of foreign commerce. The court illuminated that question a year later when it decided *Mobil Oil, supra*, 445 U.S. 425, a challenge by Mobil to Vermont's tax on foreign dividend income. Rejecting what it termed Mobil's "forced" analogy to California's tax on Japanese shipping containers at issue in *Japan Line*, the court said that the real issue before it was

not one of multiple taxation at the international level, as in *Japan Line*, but of multiple taxation at the state level.

"Concurrent federal and state taxation of income, of course, is a well-established norm," the court wrote. "Absent some *explicit directive from Congress*, we cannot infer that treatment of foreign income at the federal level mandates identical treatment by the States. The absence of any *explicit directive* to that effect is attested by the fact that Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income. [Citations.]" (*Mobil Oil, supra*, 445 U.S. at p. 448, emphasis added.)

The view taken in *Mobil Oil, supra*, 445 U.S. 425, that Congress, under its " 'exclusive and absolute' power . . . over foreign commerce" (*Japan Line, supra*, 441 U.S. at p. 448, fn. 13, quoting *Buttfield v. Stranahan* (1904) 192 U.S. 470, 492), is the source of "explicit directive[s]" *preempting* state taxation of foreign commerce, was amplified in the court's treatment of the issue in *Container, supra*, 463 U.S. 159. The court first noted that "allocating income among various jurisdictions bears some resemblance . . . to slicing a shadow," and concluded that "it would be perverse, simply for the sake of avoiding double taxation, to require California to give up one allocation method that sometimes results in double taxation [i.e., formula apportionment] in favor of another allocation method [i.e., AL/SA] that also sometimes results in double taxation." (*Id.*, at pp. 192-193.) It then turned to the "second inquiry suggested by *Japan Line*," namely, whether California's use of formula apportionment in an international context might " 'impair federal uniformity in an area where federal uniformity is essential,' " and " 'prevent the Federal Government from "speaking with one voice" in international trade.' " *(Ibid.)*

In examining the "one voice" branch of the dormant commerce clause doctrine, the court in *Container* was careful to distinguish between state tax schemes that are unconstitutional because they implicate foreign affairs and those that, although they may have "foreign resonances," are void because they "violate[ ] a clear federal directive." While either infirmity will offend the "one voice" standard, the latter does so, the court said, not as a result

of a dormant commerce clause analysis, but because of "some *explicit directive from Congress.*" This latter analysis, the court noted, "is, of course, essentially a species of pre-emption . . . ." (*Container, supra*, 463 U.S. at p. 194, emphasis added.)

Applying the "explicit directive from Congress" language of *Mobil Oil, supra*, 445 U.S. 425, and canvassing "specific indications of congressional intent," the *Container* opinion found neither statutory preemption by Congress nor any requirement that the AL/SA method be applied to the states in any of the many bilateral tax treaties to which the United States was a signatory. Indeed, the court pointed out, "the Senate has on at least one occasion, in considering a proposed treaty, attached a reservation declining to give its consent to a provision in the treaty that would have extended [an AL/SA] restriction to the States." (*Container, supra*, 463 U.S. at pp. 196-197.) "[I]t remains true," the court concluded, "as we said in *Mobil*, that 'Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income.' " (*Ibid.*)

Although the court concluded in *Container* that the Board's use of formula apportionment did not violate the foreign commerce clause under a dormant analysis, it is important for our purposes to observe that the opinion carefully separates the analytical thread of congressional *preemption* from what the court termed a "more relaxed standard which takes into account our residual concern about the foreign policy implications of California's tax." (*Container, supra*, 463 U.S. at p. 197.) In the former case, there obviously is no need for resort to a dormant analysis since Congress has *explicitly* exerted its plenary authority under the commerce power to *preempt* a state tax scheme that, far from "implicating foreign affairs," has only "foreign resonances."[9] As

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[9]Compare the court's statement in *Merrion v. Jicarilla Apache Tribe* (1982) 455 U.S. 130, 154-155, that "we only engage in [dormant analysis] review when Congress has not acted or purported to act. [Citation.] Once Congress acts, courts are not free to review state taxes or other regulations under the dormant Commerce Clause. When Congress has struck the balance it deems appropriate, the courts are no

the *Container* opinion makes clear, however, the court will not lightly overturn the historic prerogatives of the states to administer their own tax systems. Before being declared nullified by Congress under this "species of pre-emption," the "federal directive" that a state tax scheme allegedly violates must be "clear." (463 U.S. at p. 194.)

The "more relaxed standard" of a dormant analysis — based on "residual concern[s]" about the "foreign policy implications" of a given state tax scheme — is appropriate only "in the absence of explicit action by Congress" preempting a given state taxation method. It is undertaken by a judiciary with "little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please." (*Container, supra*, 463 U.S. at p. 194.) Thus, it is for reasons of its limited foreign policy expertise that, in conducting a dormant "one voice" inquiry, the "best that [a court] can do, in the absence of explicit action by Congress [preempting a challenged state tax scheme], is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations." (*Ibid.*) Where they apply, the development of such standards is informed significantly by the views of executive officials charged with implementing the nation's foreign policy — including its foreign commercial policy — "whose nuances ... are much more the province of the Executive Branch and Congress than of this Court." (*Id.*, at p. 196.)

As might be expected, the Bank argues at length that the Board's application of formula apportionment to the unitary business of which it is a part offends the foreign commerce clause

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longer needed to prevent States from burdening commerce, and it matters not that the courts would invalidate the state tax or regulation under the Commerce Clause in the absence of congressional action. [Citation.] Courts are final arbiters under the Commerce Clause only when Congress has not acted."

precisely because it violates a "clear federal directive." That directive, the Bank tells us, is embodied in an impressive array of federal executive communications — presidential statements and press releases; official letters from cabinet officers charged with overseeing national monetary, trade, and foreign policies; the testimony of senior Treasury Department officials; and the "white paper" of an executive task force established to study and present recommendations on the issues surrounding state use of formula apportionment to foreign-based unitary groups. Without exception, the Bank argues, these executive sources vigorously and explicitly support the exclusive use of the AL/SA method in such circumstances and condemn the use of formula apportionment by the states.

The Court of Appeal essentially agreed with the Bank's underlying premise that *executive* pronouncements of what national foreign commercial policy *should* be qualifies as a source of the "clear federal directive." It reasoned that because the *Container* opinion (*supra*, 463 U.S. 159) subsumed the search for specific indications of congressional intent within the "one voice" standard, congressional intent must therefore be an integral component of the dormant commerce clause test. From that analytical keystone, it had little difficultly in concluding on the basis of a substantial executive-compiled record that the federal directive was clear and explicit: according to executive branch officials, formula apportionment, in the words of the Court of Appeal, "is not to be applied to foreign-based corporate groups — those groups are to be taxed by the states only on income derived from the United States."

Were we confronted with the Bank's argument in the immediate aftermath of the *Container* decision, it might carry some force, although given the absence of textual support for the claim — both in the *Container* opinion and the commerce clause itself — it is by no means facially convincing. The fact is, however, that dormant foreign commerce clause jurisprudence has evolved in the nine years since *Container, supra,* 463 U.S. 159, was decided, an evolution that, as we parse the cases, has reoriented the doctrine. That development has reduced the scope

for a dormant analysis and makes its invocation here particularly inappropriate.

IV

Wardair: A "Governmental Silence" of a Different Kind.

Three years after its opinion in *Container, supra,* 463 U.S. 159, upholding California's use of formula apportionment in calculating the intrastate tax liability of a domestic-based unitary business, the high court decided *Wardair Canada v. Florida Dept. of Revenue* (1986) 477 U.S. 1 (*Wardair*). At issue was a Canadian-based international air carrier's challenge to an excise tax assessed by Florida on intrastate fuel purchases by common carriers, including airlines. The tax was levied at the rate of 5 percent on a deemed fuel price of $1.148 per gallon; air carriers were liable for the full amount of the tax whether the fuel was consumed in flights within or outside the state, regardless of the amount of intrastate business transacted by the taxpayer. (*Id.,* at p. 4.)

In attacking application of the tax to its Florida fuel purchases on foreign commerce clause grounds, the carrier — joined by the United States as amicus curiae — conceded that the tax, being assessed on discrete intrastate transactions, presented no risk of multiple international taxation. It relied instead entirely on the "one voice" element of the dormant foreign commerce clause analysis, the last of the six factors identified by the court in *Japan Line, supra,* 441 U.S. 434.

Specifically, the carrier contended that a patchwork of reciprocal tax exemptions, embodied in a network of multilateral agreements and conventions to which the United States was a party, manifested a national policy to exempt from state taxation the instrumentalities of international air commerce, including aviation gasoline. Florida's excise on aviation fuel purchased by a foreign carrier engaged in international air commerce, the carrier claimed, was inconsistent with that univocal national policy, thus threatening "the ability of the Federal Government to 'speak with one voice.'" (*Wardair, supra,* 477 U.S. at p. 9.)

The high court rejected the claim. Not only did the matrix of international conventions, resolutions and air commerce agreements relied on by the carrier and the United States fail to sustain a federal policy pretermiting Florida's excise on aviation fuel, the high court said, "but, even more fundamentally, [it] shows also that in the context of this case we do not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis." In point of fact, the court continued, "the international agreements cited demonstrate that the Federal Government has affirmatively acted, rather than remained silent, with respect to the power of the States to tax aviation fuel, and thus that the case does not call for dormant Commerce Clause analysis at all." (*Wardair, supra,* 477 U.S. at p. 9.)

As we explain below, the court's opinion in *Wardair, supra,* 477 U.S. 1, establishes an interpretive framework for educing from a compilation of legislative materials a species of governmental *silence* that forecloses resort to a dormant foreign commerce clause analysis. In some cases where Congress affirmatively declines to adopt certain measures, the resulting governmental "silence" is not the sort that triggers use of a dormant foreign commerce clause analysis. Properly applied under the appropriate conditions, the *Wardair* methodology interdicts judicial resort to executive branch opinions as to the international commercial effect of a challenged state taxation practice because Congress has "acquiesced in" the contested practice, thereby validating it. (*Id.,* at p. 12.) Where appropriate, *Wardair* supplants what the court has termed the "quagmire" of dormant commerce clause analysis (*Northwestern Cement Co. v. Minn., supra,* 358 U.S. 450, 458) with a heightened judicial attentiveness to expressions of congressional foreign commerce policy. Because it delimits use of dormant foreign commerce clause analysis in important ways, it is useful to lay out the analytical lines of the *Wardair* paradigm in some detail before applying it to the case before us.

The foreign carrier in *Wardair, supra,* 477 U.S. 1, relied on a hierarchy of multinational agreements to support its thesis that federal policy precluded state taxation of intrastate aviation fuel purchases by international carriers: the Chicago Convention on International Civil Aviation (Convention), signed in 1944 by the

United States, Canada, and 155 other nations; a resolution adopted in 1966 by the International Civil Aviation Organization, of which the United States was a member by virtue of being a signatory to the Convention; and more than 70 bilateral international aviation agreements between the United States and foreign nations, including a United States-Canadian aviation agreement. (*Wardair, supra*, at p. 10.) But it was these very texts, the high court concluded, that in combination impeached the existence of a national policy to exempt international air commerce from state taxation and, by their "negative implications," supported an inference that "the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel." (*Id.*, at p. 12.)

First, a provision of the Convention explicitly prohibited taxation by both national and subnational governmental units of fuel "on board" arriving international aircraft. The Convention failed, however, to reach the issue of taxing intrastate fuel *purchases* by foreign aircraft following their arrival. This omission, the court reasoned, demonstrated by "negative implication" the "international community's awareness of the problem of state and local taxation of international air travel . . . and represent[ed] a decision by the parties to [the] Convention to address the problem by curtailing . . . only some of the localities' power to tax, while implicitly preserving other aspects of that authority." (*Wardair, supra*, 477 U.S. at p. 10.)

Second, the resolution relied on by the carrier, although endorsing an international regime prohibiting duties of any kind by any taxing authority on international air travel, had "not been specifically endorsed, let alone signed, entered into, agreed upon, approved, or passed by either the Executive or Legislative Branch of the Federal Government. In other words, no action has been taken to give the Resolution the force of law." (*Wardair, supra*, 477 U.S. at p. 11.) It thus could not tenably represent, the court concluded, "a policy *of the United States*, as opposed to a policy of an organization of which the United States is one of many members." (*Ibid.*, emphasis in original.)

Third, in the years following the Convention, the United States entered into more than 70 bilateral international civil aviation

agreements, "in not one of [which] has the United States agreed to deny the States the power asserted by Florida in this case." Significantly, most of these agreements "explicitly commit the United States to refrain from imposing *national* taxes on aviation fuel used by airlines of the other contracting party . . . but . . . none . . . explicitly interdicts state or local taxes on aviation fuel used by foreign airlines in international traffic." (*Wardair, supra*, 477 U.S. at p. 11, emphasis in original internal quotation marks omitted.) Reenforcing this view, the United States-Canadian agreement also limited tax exemptions granted foreign air carriers to "national duties and charges," an "omission [to reach subnational duties] which must be understood as representing a policy choice by the contracting parties. . . ." (*Ibid.*)

Summing up the implications of this mosaic of texts for a dormant commerce clause attack on Florida's tax, the court concluded that "[w]hat all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel." (*Wardair, supra*, 477 U.S. at p. 12.) "It would turn dormant commerce Clause analysis entirely upside down," the court continued, "to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow. For the dormant Commerce Clause, in both its interstate and foreign incarnations, only operates where the Federal Government has *not spoken*. . . ." (*Ibid.*, first emphasis in original, second emphasis added.)

For our purposes, the high court's analysis of the textual materials in *Wardair, supra*, 477 U.S. 1, can be abstracted into a kind of protocol for identifying those kinds of governmental silences that give rise to "negative implications" supporting an inference of federal acquiescence in the state tax under challenge. Thus, in *Wardair* the court found that bilateral recognition of an international taxation issue and its specific treatment at the national level (numerous international aviation agreements exempting foreign air carriers from national duties), impliedly supported a finding that the failure to address the correlative issue

at the subnational level represented "a policy choice by the contracting parties." (*Id.*, at p. 11.)

By a kind of parity of reasoning, *Wardair* found that the explicit treatment of *some* subnational aspects of an international taxation issue (Convention prohibition on state taxation of fuel aboard arriving foreign aircraft) supported an inference of international "awareness of the problem" at the state level and a "decision . . . to address the problem by [limited curtailment of the subnational power] . . . while implicitly preserving other aspects of [subnational] authority." (477 U.S. at p. 10.) Last, the court found that notwithstanding an international aspiration to erect a particular tax regime (the resolution's endorsement of the complete eradication of national and subnational duties on international air travel), the fact that domestic "*law* as it presently stands acquiesces in taxation . . . by political subdivisions" was decisive of the commerce clause issue. (*Ibid.*, emphasis in original.)

Before considering the history of congressional consideration of curbs on the states' application of formula apportionment to foreign-based multinationals in light of the court's analysis in *Wardair*, we first consider the treatment of *Wardair* at the hands of the Court of Appeal.

V

The Wardair Canon and Congressional Refusal to Prohibit State Use of Formula Apportionment

A

As noted *ante*, the Court of Appeal declined to accept the view that *Wardair, supra*, 477 U.S. 1, represents, if not a change of course in the high court's dormant foreign commerce clause jurisprudence, at least a retrenchment in its scope. It also concluded that statements of executive branch officials as to United States foreign commercial policy could constitute the "clear federal directive" component to the "one voice" analysis of *Japan Line, supra*, 441 U.S. 434, *Mobil Oil, supra*, 445 U.S. 425, and *Container, supra*, 463 U.S. 159.

In our view, both of these conclusions are born of the root error of failing to grasp the conceptual impact of *Wardair, supra*, 477 U.S. 1, on dormant foreign commerce clause doctrine. As we explain, the failure of the Court of Appeal to appreciate *Wardair's* limitations on dormant commerce clause analysis is cognate to its erroneous view that executive branch aspirations as to what national foreign commercial policy ought to be can constitute a "clear federal directive," at least where, under a *Wardair* analysis, Congress has decreed otherwise.

The Court of Appeal rejected the Board's argument that *Japan Line, Container,* and *Wardair* demonstrate a trend in foreign commerce clause jurisprudence toward a heightened attention to governmental expressions of United States foreign commercial policy. Instead, it concluded that "the theoretical underpinning has remained intact through these cases." What was different in them, it thought, "was the degree to which foreign affairs and international commercial relations where implicated" by the challenged state tax scheme.

It may be that the application of such a theme to these three cases would produce a coherent alternative explanation of the results reached by the high court. To contend, however, that *Wardair, supra*, 477 U.S. 1, turns on "the degree of which foreign affairs and international commercial relations were implicated," is to misread fundamentally the court's opinion. Such a view ignores the high court's explicit statement that in *Wardair* it "[did] not confront federal governmental silence of the sort that triggers dormant Commerce Clause analysis," that the case "does not call for dormant Commerce Clause analysis at all," and that "[i]t would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted." (*Id.*, at pp. 9, 12.) We are confident that the overarching significance of *Wardair* lies in its explicit limitation on when a dormant foreign commerce clause analysis is appropriate, its affirmation that the analysis "only operates where the Federal Government has not spoken," and its statement that the court "[has] never suggested . . . that the Foreign Commerce Clause *insists* that the Federal Government speak with any particular voice." (*Id.*, at pp. 12, 13, emphasis in original.)

The Court of Appeal's misapprehension of this central meaning of *Wardair*, supra, 477 U.S. 1, led it to a related error — the conclusion, against the backdrop of an explicit *congressional* refusal to adopt curbs on state use of formula apportionment, that a trial of letters, press releases, task force reports, transcripts of congressional testimony of Treasury Department officials, and like communications orchestrated by the executive branch could constitute a "clear federal directive" condemning state use of formula apportionment in foreign parent cases. As we have indicated, however, the "clear federal directive" formulation in *Container, supra*, 463 U.S. 159, has no role to play in a dormant foreign commerce clause analysis; rather, it confirms the preemptive power of *Congress* to interdict state tax schemes that would, had Congress *not* chosen to act, survive challenge under a dormant foreign commerce clause analysis because they present only "foreign resonances." (*Id.*, at p. 194.)

Whether, in the absence of a congressionally enacted "clear federal directive," the executive branch can itself assume a preemptive role and in effect nullify state tax schemes as they affect foreign-based businesses is a distinctly different question. The Court of Appeal, relying principally on the concurring opinion of Justice Jackson in *Youngstown Co. v. Sawyer* (1952) 343 U.S. 579, 634 — the famous "steel seizure case" — concluded that such a power inhered in the President's authority to conduct foreign affairs and that the executive had spoken with sufficient clarity to prohibit state application of formula apportionment to foreign parent unitary groups such as the Bank.

In light of *Wardair, supra*, 447 U.S. 1, we need not and do not reach this issue. For in the debate over state use of worldwide formula apportionment — a controversy waged on multiple fronts by foreign governments, multinationals and their domestic and foreign affiliates, state tax authorities, senior Treasury and State Department officials, the White House and Congress — we hear the din of a "governmental silence" that cannot be ignored. In our view, Congress, after being repeatedly pushed and pulled in both directions, at least for the present has decided *not* to prohibit state use of formula apportionment in cases of this kind. To paraphrase the *Wardair* opinion, international agreements demonstrate that

the federal governmental has affirmatively acted, rather than remained silent, with respect to the power of the states to employ formula apportionment in so-called foreign parent cases; as a result, this case does not call for dormant foreign commerce clause analysis at all. (477 U.S. at p. 9.)

As we explain in some detail below, over the past 25 years, senior tax and foreign policy officials of the executive branch have sought to respond to the demands of foreign governments that the states be barred from applying formula apportionment to determine the tax liability of foreign-based multinationals. For much of this period, the chief forum for resulting executive branch initiatives was the Senate, where successive administrations sought to win ratification of a treaty provision barring state use of formula apportionment. But in 1978, with explicit recognition of the "negative implications" of its act, the Senate *rejected* an income tax convention negotiated by the executive branch with the United Kingdom whose centerpiece was a provision — article 9(4) — prohibiting the states from using formula apportionment in determining the intrastate tax liability of United Kingdom-based multinationals. Only after the ban on state use of formula apportionment was stricken was the administration able to muster the two-thirds majority required for Senate ratification under the treaty clause.

In addition, numerous bilateral tax treaties between the United States and other nations, although precluding use of formula apportionment by the signatory *national* governments, do not include within that prohibition political subdivisions such as the states. And while such tax treaties *do* include subnational governments within the scope of nondiscrimination provisions, they are *not* included within the prescription that the signatory governments employ an AL/SA methodology in taxing local branches of foreign corporations. Similarly, so-called "Friendship, Commerce and Navigation" treaties — a common form of commercial agreement between the United States and its trading partners — typically require both the federal and state governments to tax foreign enterprises within their jurisdictions on a "reasonably allocable or apportionable" basis, a standard which United States drafters viewed as "intended to cover all the various methods,

proportionate or otherwise, by which a reasonable tax base might be determined." (U.S. State Dept., Standard Draft Treaty of Friendship, Commerce and Navigation, prepared by Charles H. Sullivan (Aug. 1980) pp. 202, 203.)

Finally, in the wake of Senate rejection of article 9(4) and the decision in *Container, supra*, 463 U.S. 159, upholding California's use of worldwide unitary methods in taxing domestic-parent multinationals, the executive branch scuttled its effort to achieve treaty-imposed curbs on the states' use of worldwide formula apportionment. Instead, the administration proceeded on other fronts, first seeking the voluntary cooperation of the states in mitigating the internationally effects of formula apportionment and, in a new tack, presenting its views in selected litigation through amicus curiae participation, before again renewing its call for Congress to enact restrictive legislation.

It is in the course of this undertaking that the executive branch has produced what the Bank insists is the "clear federal directive" that sustains its dormant foreign commerce clause case. We think, however, that rather than qualifying as a "clear federal directive," these materials, in the context of Congress's persistent refusal to regulate state taxation of multinationals and the Senate's explicit rejection of article 9(4) of the United States-United Kingdom treaty, embody nothing more than executive aspirations of what the federal government's policy in this area *ought* to be.

B

In 1975, the Ford administration concluded a bilateral income tax convention with the United Kingdom, a central feature of which was the following provision, article 9(4):

"Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Con-

tracting State or of an enterprise of any third State related to an enterprise of the other Contracting State."[10]

When the succeeding Carter administration sought Senate ratification of the convention, state tax authorities attacked article 9(4) as an infringement on state powers of taxation, reached by executive branch negotiators without prior consultation with the states. They vigorously lobbied for its excision. Following a series of committee and floor votes, the Senate ultimately ratified the treaty, subject to the telling reservation "that the provisions of paragraph (4) of Article 9 . . . shall not apply to any political subdivision or local authority of the United States." (124 Cong. Rec. 18416 (1978).)

Explaining one of the motivations behind the reservation, which in effect struck article 9(4) from the treaty, its chief proponent objected to executive branch use of "the device of a tax treaty" to "impose major changes in internal tax policy" by circumventing congressional consideration of the states' use of formula apportionment. (Remarks of Sen. Church, 124 Cong. Rec. 18416 (1978).) "For some 10 years," the sponsor of the reservation stated, "Congress has been rejecting the type of limitation on the power of our State governments to tax which is incorporated in article 9(4) of the pending treaty." (*Ibid.*) Immediately following ratification of the United States-United Kingdom tax convention as amended by the so-called "Church reservation," Senator Javits, a chief sponsor of the treaty, including article 9(4), noted that "what we [the Senate] have done is very serious . . . We have for all practical purposes eliminated a very important provision of this treaty [article 9(4)] for which the United Kingdom believed it had entered into the treaty." (Remarks of Sen. Javits, 124 Cong. Rec. 19077 (1978).)

The parallels between this evidence of "governmental silence" or refusal to act and that regarded as decisive in *Wardair, supra,*

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[10](Convention Between United States and United Kingdom for Avoidance of Double Taxation, Dec. 31, 1975, 31 U.S.T. 5670, 5677, T.I.A.S. 9682.)

477 U.S. 1, seem to us both evident and compelling. As in *Wardair,* an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), "the *law* as it presently stands acquiesces" in the states' continued use of that practice. As in *Wardair,* "the negative implications" of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of "political subdivisions" from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, "must be understood as representing a policy choice by the contracting parties." (*Wardair, supra*, 477 U.S. at p. 11.)[11]

The Court of Appeal rejected the analogy to *Wardair, supra*, 477 U.S. 1, on the ground that, in both a committee vote and on the Senate floor, the Church reservation failed to command a plurality, and the vote for the treaty *with* article 9(4) was only five votes short of the needed two-thirds majority. In light of these tallies, it reasoned that it was difficult to see a congressional policy permitting the states to use formula apportionment. In our view, however, the focus on preliminary votes misses the mark.

Preliminary voting tallies lack meaning precisely because they are not definitive, may be cast for any number of tactical parliamentary reasons, and thus do not reliably reflect legislative policy. The sole constitutional mechanism for congressional consideration of executive-negotiated treaties is Senate ratification by a two-thirds majority (U.S. Const., art. II, § 2); to that defining vote, institutional significance sensibly can and should be

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[11]Parliament eventually acceded to Congress's demands, ratifying the income tax convention without article 9(4). (See 31 U.S.T., *supra*, 5709-5710.)

ascribed. In any case, the method enjoined upon us by *Wardair, supra*, 477 U.S. 1, requires that we ponder the significance of "the *law* as it stands," not count noses.

The Senate's action with respect to article 9(4) is only the most explicit example of a persistent congressional refusal to enact curbs on the states' use of worldwide formula apportionment reaching back well before 1977, the tax year at issue in this case. The parties agreed in a pretrial stipulation that "various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting." The stipulation identifies twenty such House and Senate bills spanning twenty years. These range from House Resolution No. 11798 introduced in the House in 1965 (an ambitious "Interstate Taxation Act" that would have required the states to adopt a two-factor apportionment formula in taxing unitary groups) to 1985 legislation sponsored by the Treasury Department that would have limited state use of worldwide formula apportionment to members of foreign-based corporate groups actually doing business in the United States, that is, so-called "water's edge" legislation. (See *post*, p. ___ [typed maj. opn. pp. 52-54].) None of these measures was enacted into law by Congress.

We likewise part company with the Court of Appeal in its view of the significance to be drawn from the web of bilateral tax conventions into which the United States has entered both before and after the Senate's rejection of article 9(4). As noted, these conventions typically require use of the separate accounting method by the national signatory governments in their tax treatment of domestic branches of foreign-based businesses.[12] This

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[12]Representative treaty language appears, for example, in article VII, section 2 of the United States-Canadian treaty of 1984, providing for tax treatment of domestic branches of foreign-domiciled corporations as "if it were a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently" with the rest of the corporation. (Convention Between

restriction, however, does not encompass division of income methods used by political subdivisions of the contracting states.

Again, the Court of Appeal found the analogy to *Wardair, supra*, 477 U.S. 1, inapt because, unlike that case — in which subsequent air commerce agreements rested on the foundational understanding of the Convention — many of the agreements relied on by the Board in this case predate an international awareness of formula apportionment issues that did not arise until the 1970's. Thus, according to the Court of Appeal, affirmative prescriptions of national division of income methods in international treaties would not support *Wardair's* "negative implications" that the parties were aware of competing methods and made the conscious decision to acquiesce in their use by the states.

Despite the facial plausibility of this reasoning, we cannot accept the supposition underlying it that formula apportionment as a division of income alternative to separate accounting for taxation purposes did not penetrate the international financial and diplomatic consciousness until the multinational corporate boom of the 1970's. The high court's 1924 decision in *Bass, supra*, 266 U.S. 271, upholding the constitutionality of state use of formula apportionment to a United Kingdom-based taxpayer, suggests at a minimum notice to the international business community of the valid use of an alternative to separate accounting by political subdivisions of the United States.

Although the Court of Appeal also rejected this argument on the ground that "awareness of a particular tax theory is one thing; to be subjected to that theory in practice is quite another," we think that this reasoning requires greater proof than that demanded by *Wardair, supra*, 477 U.S. 1. The dramatic growth of multinationals during the 1960's and 1970's may well have served to sharpen corporate concern over the international effects of the states' use of formula apportionment, but that increased apprehension does not demonstrate a prior lack of awareness of its

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United States and Canada with Respect to Taxes on Income and Capital, Aug. 16, 1984.)

potential applicability or negate the sensible decision of United States treaty negotiators — operating with an awareness of a federalist-based tax practice — to include a standard provision limiting only national governments to the AL/SA method.[13]

There is evidence suggesting a basis for just such an international recognition of formula apportionment as a competing taxation method, at least from the mid-1950's on. The *Container* case itself dealt with California's use of formula apportionment for the 1963 to 1965 tax years (463 U.S. at p. 171) and a prior decision of our Court of Appeal (*Anaconda Co. v. Franchise Tax Board* (1982) 130 Cal.App.3d 15) dealt with the tax years 1955 through 1969.[14] Moreover, in enacting the Internal Revenue Act of 1956, Congress authorized the Secretary of the Treasury to "distribute, *apportion*, or allocate gross income . . . between or among" multicorporate enterprises, including those with foreign

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[13]Thus, one of the leading spokesmen of executive branch opposition to state use of the worldwide unitary method, Donald Lubick, Assistant Secretary of the Treasury for Tax Policy, explained why, except for the nondiscrimination clause, subnational taxes were not included in the United States Model Income Tax Treaty by noting that "local U.S. taxes are not covered because it is unlikely that the United States would consent to the ratification of any treaty provision that restricted the rights of the . . . states to impose their own taxes." (See International Tax Treaties: Hearing Before the Sen. Com. on Foreign Relations, 96th Cong., 1st. Sess., at p. 112.)

The United States (together with two other federalist nations, Canada and Australia) likewise reserved its position "on that part of paragraph 1 [of article 1 of the Organization for Economic Co-operation and Development [OECD] Model Taxation Convention] which states that the Convention [which requires use of a separate accounting method] should apply to taxes of political subdivisions or local authorities." (Model Double Taxation Convention on Income and on Capital (1977), at p. 50.)

[14]A key 1984 Treasury Department document notes that debate on state use of the worldwide version of formula apportionment "spans *at least two decades*." (Chairman's Rep., *supra*, at p. 3, emphasis added.)

domiciles, "in order . . . clearly to reflect [their] income" (26 U.S.C. § 482, emphasis added), a formulation that reflects at least an awareness of apportionment methodologies.[15] Similarly, as early as the late 1940's, United States negotiators of "Freedom, Commerce and Navigation" agreements incorporated standards to preserve the states' freedom to employ methods that produced a tax "reasonably allocable or apportionable" to the taxing jurisdiction, a formulation American drafters described as limiting state levies to "a fair portion of a global income derived from dual or multiple territorial sources." (U.S. State Dept., Anno. Draft Treaty of Friendship, Commerce and Navigation for Portugal, prepared by Herman Walker (1947-1948) pp. 14a, 15.)

In addition, bilateral income tax treaties negotiated by the United States with many of its trading partners typically prescribe use of the AL/SA method by the signatory governments; they do not, however, impose such a requirement on taxation by subnational levels of government. Moreover, despite this methodological exemption, subnational organs of government *are* included for purposes of nondiscrimination treaty provisions. We think this latter evidence substantially parallels the *Wardair* paradigm, where the high court concluded that the "negative implications" arising from the Convention's limited ban on state taxation of fuel "on board" arriving foreign aircraft demonstrated an awareness of subnational taxation issues and represented "a decision by the parties . . . to address the problem by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority." (*Wardair, supra*, 477 U.S. at p. 10.) In short, an extensive pattern of executive branch-negotiated diplomatic texts parallels, in our view, Congress's own unwillingness to disallow legislatively the states' application of formula apportionment methods to foreign-controlled multinational taxpayers, and bespeaks a coordinate "acquiescence."

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[15]The 1954 version, as well as the current version of 26 United States Code section 482, derives from section 45 of the Revenue Act of 1928. (See H.R. Rep. No. 2, 70th Cong., 1st Sess., p. 16 (1928).)

Finally, the strategy pursued by the executive branch in the wake of the high court's opinion in *Container, supra*, 463 U.S. 159, underlines the aspirational character of its insistence on an end to state use of formula apportionment in foreign-parent cases. Although in the immediate aftermath of the decision, the administration rejected appeals by the business community and major trading partners to seek amicus curiae status in *Container* and support a rehearing, the White House soon announced an alternative plan.[16]

President Reagan directed the Secretary of the Treasury to establish a "working group" composed of representatives of the federal and state governments and the business community "charged with producing recommendations . . . that will be conducive to harmonious international economic relations, while also respecting the fiscal rights and privileges of the individual states." (Chairman's Rep., *supra*, at p. ii; see also 48 Fed.Reg. 208, p. 49570 (Oct. 26, 1983).) The final report of the working group, released in 1984 as the Chairman's Report, *ante*, footnote 3, recommended efforts by the states to mitigate the international effects of formula apportionment, including limiting its use to the "water's edge," (that is, excluding from the unitary tax base members of foreign-controlled groups not doing business in the United States). Although these state efforts at reform were to be "voluntary," in his transmittal letter to the President, Treasury Secretary Regan stated that "If there are not sufficient signs of appreciable progress by the states in this area by . . . next year, . . . I will recommend to you that the Administration propose federal legislation that would give effect to a water's edge limitation patterned after that in [the report]." (Chairman's Rep., *supra*, at p. iii.)

Eighteen months later, the administration followed up on its threat to seek congressional action. In a November 1985 statement, the President called for federal legislation that would

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[16]Pleas for administration support for a rehearing and for congressional legislation and the administrations' reaction are detailed in the Chairman's Report, *supra*, at pages 2-3.

require the states to adopt "water's edge" restrictions on the use of worldwide formula apportionment and directed the Treasury Secretary to "work with the Congress for [its] passage." At the same time, the President directed the Attorney General "to ensure that the United States' interests are represented in appropriate controversies and cases consistent with [the] approach" outlined in the President's statement. (45 Weekly Compilation of Pres. Documents 1368.) In January 1986, Secretary of State Shultz wrote to then-Governor Deukmejian informing him that legislation had been introduced before Congress "at the express direction of the President" that "would prohibit states from taxing corporations under the worldwide unitary method." (Letter of Jan. 30, 1986, from Sect. of State Shultz to Governor Deukmejian.)[17]

As a result of executive branch initiatives, some states agreed to cease using the formula apportionment method in the case of foreign-parent multinationals.[18] Others, California among them, adopted meliorative measures designed to pacify critics. In 1986, our Legislature enacted "water's edge" legislation,[19] prompting senior Treasury Department officials to retreat from their previous

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[17]Neither the Senate nor the companion House versions of the Treasury Department-drafted legislation were enacted. (See Remarks of Sen. Wilson on Sen. No. 1974, 131 Cong. Rec. S17975, daily ed. Dec. 18, 1985; remarks of Representative Duncan on H.R. No. 3980, 131 Cong. Rec. E574, daily ed. Dec. 19, 1985.)

On the legal front, the Solicitor General filed a brief amicus curiae in *Wardair, supra*, 477 U.S. 1, supporting the foreign air carrier in its unsuccessful contention that Florida's tax on aviation fuel was unconstitutional under a dormant foreign commerce clause analysis. (*Id.*, at p. 9.)

[18](See, e.g., Langbein, *The Unitary Method and the Myth of Arm's Length, supra*, 30 Tax Notes at p. 674, fn. 1. [by early 1986, four of the twelve states using worldwide unitary methods, "including all of the commercially significant states except California," had repealed them].)

[19](See Rev. & Tax. Code, § 25110 et seq.)

insistence that Congress prohibit state use of worldwide formula apportionment. For the time being, the administration told Congress, neither prohibitory congressional legislation nor treaty restrictions on state use of worldwide unitary methods was appropriate.[20]

As this account rather pointedly makes clear, the struggle for supremacy between the major interests with a stake in the fate of worldwide formula apportionment — states using that method and their federalist allies, on the one hand, and aggrieved multinationals and their supporters in the business community and the executive branch, on the other — has a long history. For much of this history, executive officials have sought unsuccessfully to impose their solution on the states through Senate ratification of a treaty provision embodying curbs and, failing that, legislation enacted under Congress's foreign commerce clause power.

Only late in the campaign have the partisans of separate accounting changed the locus of attack by seeking to have the worldwide use of formula apportionment by the states judicially invalidated on dormant foreign commerce clause grounds. In pressing that challenge, opponents of the worldwide unitary method have marshalled executive branch arguments designed to persuade Congress and the states to legislate curbs, and have attempted to transmute them into the "clear federal directive" of

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[20](Statement of J. Roger Mentz, Asst. Sect. of the Treas. for Tax Policy, before the Subcom. on Taxation and Debt Management, Sen. Finance Com. (Sept. 29, 1986), at pp. 2-3.) The Assistant Secretary's comments, stating the administration's position on Senate Bill No. 1974 — the Treasury Department-sponsored legislation drawn up at President Reagan's direction — included the view that "Congressional action on S. 1974 should be deferred until the remaining worldwide unitary states have a full opportunity to act . . ." and that "a treaty resolution of the unitary issue is [not] necessary or appropriate at this time." *(Ibid.)*

Container, supra, 463 U.S. 159.[21] As explained above, however, that doctrine underlines the plenary power of *Congress* to preempt state taxation methods with "foreign resonances"; it does not give executive officials carte blanche to declare state tax methods null when they irritate our trading partners.[22]

Conclusion

It is clear that federal limitations on the states' use of worldwide formula apportionment is a controversial political and economic issue of which Congress has long been aware. In light of that history, we cannot turn away from the substantial evidence of Congress's repeated refusal to intervene in the regulation of state division of income methods for tax purposes, even one that provokes continuing international complaint. Under the compulsions of established constitutional doctrine, the courts sometimes are required to divine what foreign commerce policy Congress

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[21]These materials consist largely of numerous diplomatic notes of complaint ("demarches") filed with the United States by its trading partners objecting to the states' use of worldwide formula apportionment, presidential statements, statements and letters from cabinet officers and other senior Treasury and State Department officials to the same effect, and official documents such as the Chairman's Report, *supra*. As noted, there is no doubt that many foreign governments object strenuously to the practice and that executive branch officials charged with conducting American foreign commercial policy agree with them.

[22]We thus reject the claim of the United States Department of Justice, appearing as amicus curiae in support of the Bank, that California's use of formula apportionment in this case is "an egregious interference with the Federal Executive's conduct of foreign affairs and is thus patently unconstitutional." Although we accept the Justice Department's argument that the views of the executive branch on the international effect of state taxation practices are entitled to "great weight" under a foreign dormant commerce clause analysis (cf. *Container, supra*, 463 U.S. at p. 196), our conclusion that such an analysis is not triggered here forecloses resort to those views. (Compare *Wardair, surpa*, 477 U.S. at p. 9 [rejecting views of United States as amicus curiae].)

would pursue in the absence of any indication that it has thought about the subject; it is a quite different matter, however, for a court to ignore a pattern of congressional action that evidences both an awareness of an issue and a refusal to adopt the remedy urged upon it by executive officials and resisted by its state constituencies. The latter, we believe, viewed in context alongside additional treaty materials, is a governmental silence that is eloquent.

In light of Congress's awareness of antagonistic state taxation and international business interests, the path taken by the high court in *Wardair, supra*, 477 U.S. 1, seems the constitutionally correct one here. To invest a paper trail of executive aspiration with the dignity of a "clear federal directive" would, in the language of *Wardair*, "turn dormant Commerce Clause analysis entirely upside down." (*Id.*, at p. 12.) Taking our lead from the high court, we decline to adjudicate on dormant foreign commerce clause grounds a debate between the political branches of the federal government over what is, in both its international and federalist dimensions, a sharply contested issue of national tax policy that has been repeatedly aired before Congress. We adhere to the central meaning of the high court's opinion in *Wardair* in holding that Congress's refusal to legislate restrictions on state use of worldwide formula apportionment is not the sort of governmental silence that triggers a dormant foreign commerce clause analysis.

Our holding does not end the matter, however. The trial court held that the cost to a foreign-based unitary enterprise of furnishing financial data required by the Board's use of the worldwide formula apportionment method — the so-called "compliance burden" — violated due process. In addition, it held that same burden violated the nondiscrimination requirement of the four-part dormant interstate commerce clause analysis under *Complete Auto Transit, Inc. v. Brady, supra*, 430 U.S. 274.

The Court of Appeal explicitly declined to decide the due process issue and does not appear to have passed directly on the nondiscrimination issue. The due process issue is a fact-dependent question that should be decided by the Court of Appeal in the first instance; moreover, we think its examination of the issue

would profit from a consideration of its merit free of the view that a dormant foreign commerce clause analysis is appropriate in the circumstances present here.

Accordingly, the judgment of the Court of Appeal is reversed and the cause is remanded to that court for further proceedings consistent with this opinion.

ARABIAN, J.

WE CONCUR:
LUCAS, C. J.
MOSK, J.
PANELLI, J.
KENNARD, J.
BAXTER, J.
GEORGE, J.

BARCLAYS BANK INTERNATIONAL, LTD. v.
FRANCHISE TAX BOARD

S019064

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TRIAL COURT:	Sacramento County Superior Court
TRIAL COURT #:	325059

The information provided here is not intended to reflect that which will appear in official reports.

APPENDIX B

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF
THE STATE OF CALIFORNIA IN AND FOR
THE THIRD APPELLATE DISTRICT
(Sacramento)

BARCLAYS BANK INTERNATIONAL, LTD.,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

BARCLAYS BANK OF CALIFORNIA,
Plaintiff and Respondent,
v.
FRANCHISE TAX BOARD,
Defendant and Appellant.

C003388
(Super. Ct. Nos. 325059 & 325061)

Filed November 30, 1990

COURT OF APPEAL - THIRD DISTRICT

BY Robert L. Liston, Clerk
DEPUTY

APPEAL from judgments of the Superior Court of Sacramento County, George E. Paras, Retired Associate Justice of the Court of Appeal, sitting under assignment by the Chairperson of the Judicial Council. Affirmed.

John K. Van de Kamp, Attorney General, Timothy G. Laddish, Assistant Attorney General, Robert F. Tyler, Supervising Deputy Attorney General, and Robert D. Milam, Deputy Attorney General, for Defendant and Appellant.

Joanne M. Garvey, Joan K. Irion, Teresa A. Maloney, and Heller, Ehrman, White & McAuliffe, for Plaintiffs and Respondents.

Lawrence V. Brookes and Valentine Brookes as Amici Curiae for Thorn-EMI PLC and EMI Limited, on behalf of Plaintiffs and Respondents.

Jane H. Barrett, Lawler, Felix & Hall, and F. Eugene Wirwahn as Amici Curiae for the Government of the United Kingdom and the Government of Canada, on behalf of Plaintiffs and Respondents.

David F. Levi, United States Attorney, William S. Rose, Jr., Assistant Attorney General, and Gary R. Allen, David English Carmack, John J. McCarthy, and Richard A. Correa, Attorneys, Department of Justice, as Amicus Curiae for the United States of America, on behalf of Plaintiffs and Respondents.

In this appeal we hold that California's unitary tax method of worldwide combined reporting (based on Rev. & Tax. Code, §§ 25101, 25120-25138), as applied to foreign-based unitary groups, is unconstitutional under the foreign commerce clause of the United States Constitution. (U.S. Const., art. I, § 8, cl. 3.)[1]

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[1]During the tax year at issue (1977), section 25101 of the Revenue and Taxation Code provided in pertinent part as follows: "When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120 of this chapter); . . ."

Article 2 contains the California enactment of the Uniform Division of Income for Tax Purposes Act (UDITPA), which provides for formula apportionment of the net income from business activities both within and outside California in order to reach the net income attributable to California activities. (Rev. & Tax. Code, §§ 25120-25138.)

In 1982, section 25101 was amended in an insignificant fashion for our purposes. (Stats. 1982, ch. 466, § 104, p. 2055.)

BACKGROUND

When a corporation conducts business in more than one jurisdiction, either through branches or subsidiaries, the proper allocation of income for tax purposes becomes an issue. Essentially, two methods of allocating income have evolved to resolve this issue: the arm's length/separate accounting method (AL/SA) and the unitary business/formula apportionment method. As to multinational corporations, California employs a common variant of the unitary method called worldwide combined reporting (WWCR).

Under the separate accounting method, the various affiliated corporations of a multijurisdictional enterprise are viewed as separate from one another and the income attributable to any particular jurisdiction is determined on the basis of internal accounting records reflecting the activity of the affiliate within that jurisdiction. To preclude tax-manipulative intercorporate transfers of goods, services or other value, this accounting method requires that the tax reporting entity deal at "arm's length" with its affiliated businesses as if they were simply unrelated entities dealing in the marketplace.

In contrast, under the unitary business/formula apportionment method of accounting employed by California (WWCR), the affiliated corporations of a multijurisdictional enterprise are treated as units of a single business — that is, as a "unitary group." (Cal. Code Regs., tit. 18, § 25137-6.) If a corporation doing business in California is deemed to be part of a unitary group, the total income for that group, including corporations or affiliates operating wholly outside California or the United States for that matter, is apportioned to California by a three-factor formula. The formula takes into account property, payroll, and sales (revenue in this case) for the group in California, as a fraction of total worldwide property, payroll, and sales. (See Rev. & Tax. Code, §§ 25128-25136; Notes, *State Worldwide Unitary Taxation: The Foreign Parent Case* (1985) 23 Columbia Journal of Transnational Law 445, fn. 2; hereafter 23 Columbia Journal.) The fraction is then multiplied against the unitary group's total income, producing an apportioned amount of such income taxable by California. Because intercorporate transactions are disregarded, it is unnecessary to make "arm's length" adjustments.

The income allocation method used by the United States and all of the other nations of the world, with a couple of minor and limited exceptions, is the AL/SA method, although this method varies in practice. However, the United States has essentially limited the application of its tax treaties to federal taxes. Apparently no nation in the world uses WWCR in any meaningful fashion.

The present controversy involves challenges to additional tax assessments for the year 1977 resulting from California's use of WWCR.[2] Those additional assessments were levied after the

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[2]In 1986, California passed legislation, operative January 1, 1988, permitting taxpayers to make a "water's-edge election" notwithstanding section 25101 (Rev. & Tax. Code, § 25110 et seq.).

The "water's-edge" method is essentially an AL/SA method, and offers an alternative to the WWCR method for determining taxable income. (See Rev. & Tax. Code, §§ 25101, 25110.) Instead of accounting for the income and apportionment factors (property, payroll, and sales) of all the members of its worldwide unitary group, a corporate taxpayer making such an election accounts for the income and apportionment factors of the following entities affiliated with it, subject to some technical exceptions: corporations incorporated in the United States; any corporation, wherever incorporated, if the average of its apportionment factors within the United States is 20 percent or more; affiliated corporations which are eligible to be included in a federal consolidated tax return; domestic international sales corporations and foreign sales corporations engaged in sales in the United States; export trade corporations; any corporation not set forth previously but only to the extent of its income derived from or attributable to sources within the United States; and any affiliated corporation which is a controlled foreign corporation as defined in the Internal Revenue Code. Any corporation not subjected to WWCR under Revenue and Taxation Code section 25101 need not be included in this "water's-edge" accounting. (Rev. & Tax. Code, § 25110, subd. (a).)

In general, this election permits a taxpayer corporation to exclude the income and apportionment factors of foreign incorporated affiliates from the corporation's California tax base. In the context of state taxation of multinational corporations, an accounting restriction to the water's edge of the United States means that a state tax authority relies only on

defendant California Franchise Tax Board (Board) determined that the plaintiff taxpayers, Barclays Bank of California (Barcal) and Barclays Bank International (BBI), and their ultimate corporate parent, Barclays Bank Limited (BBL), as well as the significant subsidiaries of BBI and BBL, constituted a unitary group.[3] Barcal was directed to pay an additional $152,420 and BBI an additional $1,678. Under protest Barcal and BBI (hereafter referred to collectively as either plaintiffs or Barclays) paid the additional taxes and this suit ensued.

Plaintiffs challenge the federal constitutionality of these additional tax assessments on foreign commerce clause and due

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income derived from permanent establishments of the corporation in the United States, and not on income derived from wholly foreign interests, to calculate the corporation's franchise tax. Essentially, then, California's "water's-edge election" is a separate accounting method with the United States as the jurisdictional boundary.

Only "qualified taxpayers" can make a water's-edge election. To qualify, the corporate taxpayer must (1) consent to the taking of depositions from key corporate personnel and to the production of documents to ensure the Franchise Tax Board has the information necessary to make genuine arm's length adjustments and unitary business investigations, and (2) agree that dividends received by any affiliated entity from corporations significantly related to the unitary business constitute business income of the taxpayer. (Rev. & Tax. Code, § 25110, subd. (b) (2).) Additionally, to make the election the corporate taxpayer must enter into a five-year contract with the Franchise Tax Board, pay an annual fee, and subject itself to various conditions. (Rev. & Tax. Code, §§ 25111-25115.)

A foreign-based multinational corporation that does not make this election is subjected essentially to the 1977 taxation method at issue here. (See fn. 1, *ante*, pp. 2-3.) We emphasize, however, that the issue we confront is the constitutionality of California's unitary tax method of WWCR as applied to foreign-based unitary groups (Rev. & Tax. Code, § 25101 et seq.). Because California's "water's-edge election" is not involved in this case, we express no view regarding it. (Rev. & Tax. Code, § 25110 et seq.)

[3]Barcal and BBI do not challenge the determination that they are part of a unitary group.

process grounds. For us, the critical issue concerns the foreign commerce clause.

Foreign Commerce Clause

Before beginning our analysis, we note that plaintiffs also contend the WWCR unitary method is unconstitutional because it improperly interferes with the power of the executive branch of the federal government to conduct foreign affairs. (See United States v. Curtiss-Wright Export Corp. (1936) 299 U.S. 304 [81 L.Ed 255].) The Board argues here, as it did below, that plaintiffs' failure to raise the latter issue in their claim for refund precludes their assertion on appeal. The trial court rejected the argument, reasoning that the protest proceedings provided adequate notice of the issue and, more importantly, the Board lacked the authority to address constitutional issues. There is substantial evidence supporting the trial court's determination of adequate notice; it would have been a futile exercise to raise this constitutional issue involving sensitive matters of international relations before the Board. (See Park'N Fly of San Francisco, Inc. v. City of South San Francisco (1987)188 Cal.App.3d 1201, 1208-1209, 1215-1216.) Moreover, as we shall explain, the dispute is irrelevant as the foreign commerce clause issue inextricably involves foreign affairs, the subject of foreign affairs inextricably involves the two political branches of our national government, and the foreign commerce clause issue was undeniably raised in a timely fashion. With these prefatory remarks in mind, we address the substance of the matter.

Article I, section 8, clause 3 of the United States Constitution gives Congress the power "To regulate commerce with foreign nations, and among the several states, . . ."

As noted by the trial court, three United States Supreme Court decisions that have construed this provision in the last decade are vital to the positions of each of the parties to this litigation. Those cases are: Japan Line, Ltd. v. County of Los Angeles (1979) 441 U.S. 434 [60 L.Ed.2d 336]; Container Corp. v. Franchise Tax Bd. (1983) 463 U.S. 159 [77 L.Ed.2d 545]; and Wardair Canada v. Florida Dept. of Revenue (1986) 477 U.S. 1 [91 L.Ed.2d 1].

In *Japan Line,* the high court held that instrumentalities of commerce (in that case, cargo containers in seagoing ships) that are owned, based, and registered abroad and that are used exclusively in international commerce may not be subjected to an apportioned ad valorem property tax by a state. (441 U.S. at pp. 436, 444 [60 L.Ed.2d at pp. 340, 345].)

Through *Japan Line,* the so-called "dormant" foreign commerce clause test of constitutional review came into being. The judiciary engages in dormant commerce clause analysis when the Congress has not acted or purported to act; in such situations, it is the judiciary's responsibility to determine whether an action taken by a state unduly threatens the underlying purpose of the clause: to ensure a free flow of commerce and that individual states do not work to the detriment of the nation as a whole. (Merrion v. Jicarilla Apache Tribe (1982) 455 U.S. 130, 154-155 [71 L.Ed.2d 21, 40]; *Wardair, supra,* 477 U.S. at pp. 7-8 [91 L.Ed.2d at pp. 9-10].)

This dormant foreign commerce clause test was engendered through the engrafting of two additional inquiries onto the already existing four-part test for dormant *Interstate* commerce clause review. (*Japan Line, supra,* 441 U.S. at pp. 444-445, 451 [60 L.Ed.2d at pp. 345-346, 349].)

That four-part test upholds a state tax against an interstate commerce clause challenge if the tax "'[i] is applied to an activity with a substantial nexus with the taxing State, [ii] is fairly apportioned, [iii] does not discriminate against interstate commerce, and [iv] is fairly related to the services provided by the State.'" (*Japan Line, supra,* 441 U.S. at pp. 444-445, 449, 454 [60 L.Ed.2d at pp. 345, 348, 351], quoting Complete Auto Transit, Inc. v. Brady (1977) 430 U.S. 274, 279 [51 L.Ed.2d 326, 331].) The two additional inquiries prompted by the foreign context are first, whether the tax creates a "substantial risk of international multiple taxation" (441 U.S. at p. 451 [60 L.Ed.2d at p. 349]), and, second, whether the tax "may impair federal uniformity in an area where federal uniformity is essential" (*Id.*, at p. 448 [60 L.Ed.2d at p. 347]), and prevents "the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax

contravenes either of these precepts, it is unconstitutional under the Commerce Clause." (*Id.*, at p. 451 [60 L.Ed.2d at p. 349], quoting Michelin Tire Corp. v. Wages (1976) 423 U.S. 276, 285 [46 L.Ed.2d 495, 503]; *Container, supra*, 463 U.S. at pp. 193-194 [77 L.Ed.2d at p. 571].)

The court in *Japan Line* assumed, without deciding, that the tax at issue passed constitutional muster under the four-part interstate test, and proceeded to ask the two new questions. (441 U.S. at p. 451 [60 L.Ed.2d at p. 349].)

The court had little difficulty in determining that California's property tax failed the first additional test: since the facts showed that Japan taxed the cargo containers at full value, California's tax created more than the risk of multiple taxation; it in fact produced such taxation. (*Japan Line, supra*, 441 U.S. at pp. 451-452 [60 L.Ed.2d at pp. 349-350].)

The court decided rather easily that California's tax prevented the nation from "speaking with one voice" in regulating foreign trade. (*Japan Line, supra*, 441 U.S. at pp. 452-453 [60 L.Ed.2d at pp. 350-351].) The court cited the Customs Convention on Containers, which both the United States and Japan had signed, and stated it reflected a national policy to remove all duties and taxes as to temporarily-imported containers in international traffic. (*Id.*, at pp. 452-453 [60 L.Ed.2d at pp. 350-351].) Since American-owned containers are not taxed in Japan, California's tax creates an asymmetry in international taxation operating to Japan's disadvantage; under such circumstances, the risk of retaliation by Japan is acute, a retaliation that of necessity would be borne by the entire nation. Finally, if other states were to follow California's example, taxation would vary port-by-port, making speaking with one voice impossible. (*Id.*, at p. 453 [60 L.Ed.2d at pp. 350-351].)

The relative ease with which these constitutional invalidations were made is grounded in the *Japan Line* court's sensitivity to intrusions by individual states into the realm of foreign affairs. (See also Hines v. Davidowitz (1941) 312 U.S. 52, 63 [85 L.Ed. 581, 584-585]; United States v. Belmont (1937) 301 U.S. 324, 330-331 [81 L.Ed. 1134, 1139].) As to the first inquiry, the court

noted that "[e]ven a slight overlapping of tax — a problem that might be deemed de minimis in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." (Fn. omitted; *Japan Line, supra*, 441 U.S. at p. 456 [60 L.Ed.2d at p. 352].) When confronted with the assertion that it was Japan's levy rather than California's which created the double tax, the court responded, "California's tax, however, must be evaluated in the *realistic framework of the custom of nations* . . . ." (Emphasis added, *id.*, at p. 454 [60 L.Ed.2d at p. 351].)

Regarding the second inquiry, the court stressed that the foreign commerce power of Congress is greater than its interstate commerce power, and emphasized not only the need for uniformity in dealing with other nations but "the Framers' overriding concern that 'the Federal Government must speak with one voice when regulating commercial relations with foreign governments.'" (*Japan Line, supra*, 441 U.S. at pp. 448-449 [60 L.Ed.2d at pp. 347-348].) Of course *Japan Line* involved a property tax on a foreign cargo container, not a particular method of income tax allocation applied to a foreign-based unitary group.

The case of Container Corp. v. Franchise Tax Bd. supra, 463 U.S. 159 [77 L.Ed.2d 545], to which we turn now, involved not only a particular income tax method but the one at issue here.

Container held in part that California's application of WWCR to domestic-based unitary groups was constitutional under the dormant foreign commerce clause test enunciated in *Japan Line*. (463 U.S. at pp. 185-197 [77 L.Ed.2d at pp. 566-573].) Container Corporation was a business entity incorporated in Delaware and headquartered in Illinois with 20 subsidiaries in 4 European and 4 Latin American countries. (*Id.*, at pp. 163, 171 [77 L.Ed.2d at pp. 551, 557].)

At the outset of its foreign commerce clause discussion, the court in *Container* stated that "[t]he case most relevant to our inquiry is *Japan Line*." (463 U.S. at p. 185 [77 L.Ed.2d at p. 566].) Following *Japan Line, Container* applied the two additional foreign commerce clause considerations there set forth. (463 U.S. at pp. 185-186 [77 L.Ed.2d at pp. 566-567].)

Before applying those two additional considerations, *Container* noted the similarities and differences between the two cases. Similarities included the fact that actual double taxation had resulted, that such taxation stemmed from a serious divergence between California and foreign taxing methods, that the foreign taxing method was consistent with international practice (i.e., AL/SA), and that "our own Federal Government, to the degree it has spoken, seems to prefer the taxing method adopted by the international community to the taxing method adopted by California." (Fn. omitted, 463 U.S. at pp. 184, 187 [77 L.Ed.2d at pp. 565, 567].)

Three differences were noted. First, the tax in *Container* was on income rather than on property, and the court noted the ease with which income traverses boundaries. Second, the double taxation, although real, was not the " 'invevitabl[e]' result of the California taxing scheme." Finally, the tax in *Container* fell, not on the foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States. (463 U.S. at pp. 187-188 [77 L.Ed.2d at pp. 567-568].) After essentially analogizing a corporation and an instrumentality of commerce, *Container* carefully noted "[w]e have no need to address in this opinion the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (*Id.*, at p. 189, including fn. 26 [77 L.Ed.2d at p. 568].) It is important to note at this juncture that those issues are the crux of the matter presented here.

In applying the first additional test set forth in *Japan Line*, *Container* noted *Japan Line*'s concern that even slight overlapping of tax assumes importance in the sensitive area of foreign relations, but further noted that this concern did not express an absolute prohibition on stated-induced double taxation. While such taxation deserves close scrutiny, said *Container*, that scrutiny must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing state. (463 U.S. at p. 189, [77 L.Ed.2d at pp. 568-569].) Taking into account the context of the tax, the distinction between an income tax and a property tax, and the fact

that even implementing AL/SA would not guarantee an end to double taxation, *Container* concluded that since California's taxing method did not "inevitably" lead to double taxation, it would be perverse to constitutionally require one method of taxation over another when both could result in a double tax. (*Id.*, at pp. 189-193 [77 L.Ed.2d at pp. 568-571].)

Proceeding to *Japan Line*'s second inquiry — that is, the "one-voice" standard — *Container* stated: "In conducting this inquiry, . . . we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer, '[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment by the States.' [Citations.] Thus, a state tax at variance with federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive [the second of these considerations being essentially a preemption analysis]." (Emphasis in original, 463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572].)

In applying this refinement of the one-voice standard, *Container* noted that the most obvious foreign policy implication of a state tax is the threat it might pose of offending foreign trading partners and leading them to retaliate against the nation as a whole. *Container*, however, said the judiciary has little competence in making these determinations on a theoretical basis, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the states tax as they please. (463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) The *Container* court emphasized that the nuances of foreign policy "are much more the province of the Executive Branch and Congress than of this Court." (*Id.*, at p. 196 [77 L.Ed.2d at p. 573].) According to *Container*, the best a court can do is try to develop objective standards that reflect general observations about international trade and relations. (*Id.*, at p. 194 [77 L.Ed.2d at p. 572].)

Container provided three reasons that weighed strongly against the possibility of justifiable and significant foreign retaliation. First, California's taxing method as applied to domestic-based

unitary groups did not create an "*automatic* 'asymmetry' " in international taxation operating to a foreign entity's disadvantage. (Emphasis in original, 463 U.S. at pp. 194-195 [77 L.Ed.2d at p. 572].) Second, the method was imposed not on a foreign entity, as was the case in *Japan Line*, but on a domestic corporation. At this point, the *Container* court noted that a tax falling on a domestic corporation "might be less significant in the case of a domestic corporation that was owned by foreign interests," that is, the court again noted it was not dealing with the issue presented here. (*Id.*, at p. 195, including fn. 32 [77 L.Ed.2d at p. 572].) Third, even if foreign nations had a legitimate interest in reducing the tax burden of domestic corporations, that burden is more the function of tax rate than of allocation method, and California can simply raise its rate to achieve the same foreign economic effect. *(Ibid.)*

After stating that the threat of retaliation was not the only foreign policy implication a state tax may have, the *Container* court noted there was no amicus curiae brief from the executive branch opposing the tax (463 U.S. at p. 195 [77 L.Ed.2d at pp. 572-573]), and indicated that although the lack of such a brief was not dispositive, it did suggest that United States foreign policy was not seriously threatened by California's application of WWCR to domestic-based corporate groups. (*Id.*, at pp. 195-196 [77 L.Ed.2d at p. 573].)

After concluding that foreign affairs were not implicated by California's unitary tax in a domestic-based multinational context, the *Container* court inquired whether the tax violated a "clear federal directive." For the following reasons, no such directive was found.

There was no federal statute on point. While there were numerous tax treaties that committed the federal government to use an arm's length method in taxing the domestic income of multinational enterprises, that requirement was generally waived as to contracting nations taxing their own domestic corporations. This fact, if nothing else said the *Container* court, "confirms our view that such taxation is in reality of local rather than international concern." (463 U.S. at p. 196 [77 L.Ed.2d at p. 573].) Those tax treaties did not generally cover the taxing activities of

states, and in none of them did the requirement of arm's length accounting apply to the states. Moreover, the United States Senate had on one occasion declined to give its two-thirds consent to a treaty provision that would have prohibited the states from using WWCR. Finally, the court noted that Congress had long debated but not enacted legislation designed to regulate state taxation of income. In light of these circumstances, the court in *Container* could not conclude that California's unitary tax method, as applied to domestic-based unitary groups, was preempted by federal law or fatally inconsistent with federal policy. (463 U.S. at pp. 196-197 [77 L.Ed.2d at p. 573].)

Unlike *Japan Line* and *Container*, the United States Supreme Court in Wardair Canada v. Florida Dept. of Revenue, supra, 477 U.S. 1 [91 L.Ed.2d 1], did not engage in a dormant commerce clause analysis, finding it "abundantly clear" that the federal government had affirmatively acted rather than remained silent with respect to the issue there: the power of a state to tax all airline aviation fuel sold within the state regardless of the airliner's destination or the amount of intrastate business it did. (Pp. 9, 12 [91 L.Ed.2d at pp. 10, 12].)

In *Wardair*, the airliner and the United States as amicus curiae argued there was a federal policy prohibiting such an unlimited tax, a policy manifested by (1) the 1944 Chicago Convention on International Civil Aviation (1944 Convention), which the United States had signed; (2) a 1966 Resolution of the International Civil Aviation Organization (1966 Resolution), an organization to which the United States belonged; and (3) more than 70 bilateral aviation agreements, including the 1974 US-Canadian Aviation Agreement (Agreement). (Wardair was a Canadian airline.) The court in *Wardair* saw things much differently. Not only did this evidence fail to reveal any such policy, said the court, but showed the federal government had affirmatively acted to permit the tax at issue, thus precluding application of the dormant foreign commerce clause test enunciated in *Japan Line*. (477 U.S. at pp. 8-12 [91 L.Ed.2d at pp. 9-12].)

Wardair's analysis proceeded as follows. The 1944 Convention only prohibited the local taxation of aviation fuel " 'on board an aircraft . . . on arrival . . . and retained on board on leaving.' "

(477 U.S. at p. 10 [91 L.Ed.2d at p. 11].) That provision, said the court, demonstrated the international community's awareness of the problem of state taxation of aviation fuel, and represented a decision by the Convention parties to address the problem by limiting only some of the localities' power to tax while implicitly preserving other aspects of that authority. (*Ibid.*) While the 1966 Resolution undeniably endorsed an international scheme to exempt fuel tax " ' "from all customs and other duties," ' " neither the executive nor the legislative branch had acted in any way to give the Resolution the force of law. (*Id.*, at pp. 10-11 [91 L.Ed.2d at p. 11].) And after the Convention came into force, the United States entered more than 70 bilateral aviation agreements, not one of which prohibited the states from imposing a tax like Florida's. (*Id.*, at p. 11 [91 L.Ed.2d at pp. 11-12].) The US-Canadian Agreement itself was limited to " 'national duties and charges,' " an especially striking feature given that (1) the Agreement was completed eight years after the 1966 Resolution specifically addressed the concern of subnational taxation, and (2) both signatories were federalist nations. (*Id.*, at pp. 11-12 [91 L.Ed.2d at pp. 12].) Moreover, throughout the duration of the Agreement, other American states and some Canadian provinces had imposed fuel taxes similar to Florida's without challenge, a course of conduct suggesting that the parties to the Agreement and those most immediately affected by it understood it to permit this taxation. (477 U.S. at p. 12 [91 L.Ed.2d at pp. 12].)

"What all of this makes abundantly clear," said the court in *Wardair*, is that the federal government has not remained silent but "[b]y negative implication" "has at least acquiesced" in the state taxation at issue. (477 U.S. at p. 12 [91 L.Ed.2d at pp. 12].) The dormant commerce clause test of *Japan Line* was deemed inapplicable because "the Federal Government ha[d] affirmatively decided to permit the States to impose these sales taxes on aviation fuel." (*Ibid.*)

Notable is the fact that the *Wardair* court continually reaffirmed the foreign dormant commerce clause test created in *Japan Line*, but failed to find an opportunity to employ it. Also notable is *Wardair's* recognition of the basic value underlying that clause: to "ensure that the essential attributes of nationhood will

not be jeopardized by States acting as independent economic actors." (477 U.S. at p. 12; see also pp. 7-8 [91 L.Ed.2d at p. 12].) And the heightened importance of this value in the context of foreign commerce was recognized by *Wardair* when it stated: "In the unique context of . . . foreign commerce, we have alluded to the special need for federal uniformity: ' "In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power" ' [quoting *Japan Line, supra*, 441 U.S. at p. 448 [60 L.Ed.2d 336], quoting Board of Trustees v. United States (1933) 289 U.S. 48, 59 [77 L.Ed. 1025]." (477 U.S. at p. 8 [91 L.Ed.2d at p. 9].)

With the various holdings and analysis of the problems decided in *Japan Line, Container,* and *Wardair* in mind, we turn to the present context. The first issue to be resolved is whether the Board is correct that our case tracks *Wardair*, rendering a dormant commerce clause analysis unnecessary. For the reasons that follow, we think the Board is incorrect in its conclusion.

Preliminary, we reject the Board's suggestion that the three decisions, *Japan Line, Container,* and *Wardair*, together manifest a significant retrenchment in the sensitivity shown to foreign relations. Both *Container* and *Wardair* reaffirmed *Japan Line's* sensitivity to the unique context of foreign commerce and the special need for federal uniformity in international relations. To us, the theoretical underpinning has remained intact through these cases. What was different in them was the degree to which foreign affairs and international commercial relations were implicated. In *Japan Line*, the factual context presented an international asymmetry, an acute risk of retaliation, and varying degrees of international multiple taxation. By contrast, in *Container,* there was a minimal risk of retaliation, a largely domestic context, and executive branch silence; and in *Wardair*, both the American government and the Canadian government (the foreign country involved) had essentially agreed to permit the subnational taxation at issue. Far from demonstrating any significant retrenchment in the sensitivity shown to foreign relations, the three cases demonstrate how that sensitivity is aligned with the degree to which such relations are implicated.

Relying upon five perceived indications of executive and congressional acquiescence in light of the principles of *Wardair*, the Board contends an affirmative federal policy permitted California's use of WWCR. Those five factors are (1) the failure to consider state taxes in United States income tax treaties with foreign countries, except in nondiscrimination clauses; (2) the actions by the executive branch in adopting a Model Income Tax Treaty and in reserving its position on the Organization of Economic Cooperation and Development (OECD) Model Convention's application to subnational taxes; (3) Friendship, Commerce, and Navigation (FCN) Treaties to which the United States is a party do not require the states to use any particular method of tax accounting; (4) the absence of enacted congressional legislation prohibiting or restricting the states' use of WWCR; and (5) the rejection by the United States Senate of article 9(4) in the United States-United Kingdom Tax Treaty, the only attempt by the executive branch to alter federal acquiescence in the states' use of WWCR.

In analyzing the treaties and treaty actions encompassed in factor (1) through (3), we find little, if any, support for the Board's position. True, these treaties and actions reflect a *general* policy at the federal level of noninterference in state taxation, but they do so to preserve the *general* principle of state sovereignty. Not one of the treaties or actions, except for the U.S.-U.K. Tax Treaty to which we shall come, specifically addresses the unitary tax method or the use of WWCR by subnational units. The treaties either state in general terms that they apply to national taxes, or contain general provisions regarding subnational taxes. The reservations were made to model treaty provisions that state generally that the treaties should apply to subnational taxes. Moreover, it was not until the 1970's when use of WWCR in an international context essentially began that a problem of international dimension arose. (Cal. Code Regs., tit. 18, § 25137-6; see Comment, *California's Corporate Franchise Tax: Taxation of Foreign Source Income?* (1980) 20 Santa Clara L. Rev. 123, 131-136; hereafter 20 Santa Clara L.Rev.) Many of the treaties

predate the existence of the problem and therefore do not discuss it.[4]

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[4]The Board chides the trial court for determining that pre-1978 tax treaties were largely irrelevant to this case. To support its position, the Board cites the 1924 United States Supreme Court decision in Bass, Ratcliff & Gretton v. State Tax Commission, 266 U.S. 271 [69 L.Ed. 282]. In *Bass*, the court constitutionally validated New York's application of a unitary business/formula apportionment method to the overall income of a British brewing company that imported a portion of its product through branch offices in New York and Chicago. Because of *Bass*, says the Board, the international community has been well aware since 1924 of this income allocation alternative to the AL/SA method.

Rather than support the Board's argument, we think *Bass* undermines it. Awareness of a particular tax theory is one thing; to be subjected to that theory in practice is quite another. Though *Bass* and its foreign-based unitary tax concept have been around since 1924, it was not until the early 1970's when the concept began to be noticeably *applied* that the problem of unitary taxation in the international arena arose. That history supports the idea that such a tax, though known as a concept, was little applied in international practice and thus largely irrelevant beyond our borders. (See Mobil Oil Corp. v. Commissioner of Taxes (1980) 445 U.S. 425, 438-439, 446-448 [63 L.Ed.2d 510]; *Container, supra*, 463 U.S. at pp. 163-165, 168-169, including fn. 7, 185-197 [77 L.Ed.2d 545].) All of this supports the trial court's eminently sensible determination that a tax treaty cannot be relevant to a tax problem that did not exist and was not foreseeable at the time the treaty was negotiated. Like judicial decisions, the older tax treaties here cannot sensibly be considered authority for propositions not considered.

In a somewhat related vein, the Board also cites *Bass* as constitutionally validating the unitary tax method as applied to foreign-based corporations. For a number of reasons, we disagree. First, *Bass* was decided before the United States developed its network of international tax treaties. (See 23 Columbia Journal at p. 450, fn. 32.) Second, *Bass* did not discuss foreign policy implications. Third, *Bass* obviously did not have the opportunity to apply the foreign dormant commerce clause test as enunciated in *Japan Line*. Finally and most importantly, *Container* cited *Bass* three times in passing yet twice explicitly reserved determining the constitutionality of the unitary tax method as applied to foreign-based corporate groups. (*Container, supra*, 463 U.S. at pp. 164-166, 189, fn. 26, 195, fn. 32 [77 L.Ed.2d 545].) *Bass*'s importance fades consider-

Contrast the treaty analysis in *Wardair*. There, the specific subject matter encompassing the tax at issue, as well as inextricably related taxes, had been discussed in the 1944 international Convention well before the aviation agreements were negotiated. Many of these agreements also postdated the 1966 international Resolution which specifically discussed the subject matter encompassing the tax. The American government and the international community were therefore negotiating these agreements with a keen awareness of the tax involved in *Wardair*. In fact, *Wardair* involved an issue of subnational taxation and the most relevant agreement in that case — the United States-Canadian Agreement — was signed by two federalist nations 30 years after the 1944 Convention and 8 years after the 1966 Resolution; furthermore, the course of conduct under this agreement indicated the tax at issue was permitted.

The Board's approach is simply too general and ignores historical context in essentially arguing that when a treaty is limited to national taxes or fails to discuss a particular taxation method, a conscious decision has been made to allow states to tax in *any* manner they please. Common sense charts a different course while respecting the broad power of a state to tax. (See Hines v. Davidowitz, supra, 312 U.S. at p. 68 [85 L.Ed. at pp. 587-588].)

In an attempt to be more specific, the Board does note that many of the bilateral tax treaties contain nondiscrimination clauses applicable to the states. The Board argues that these clauses give rise to a *Wardair*-like "negative implication" of a decision by the treaty parties to resolve the problem of state taxation by curtailing only some of the states' power to tax, while implicitly preserving other aspects of that authority. (*Wardair, supra*, 477 U.S. at pp. 10, 12 [91 L.Ed.2d at pp. 11, 12].) Again, we disagree.

In *Wardair*, the negative implication arose because foundation agreements had addressed not only the specific subject matter encompassing the tax at issue but specific taxes within that subject, without addressing the tax at issue. Subsequent agree-

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ably in light of these factors. (See 20 Santa Clara L.Rev. at pp. 126-128.)

ments were negotiated and conducted in the atmosphere of these foundational ones. The nondiscrimination clauses do not provide a similar parallel here. Those clauses are simply reflections of a general principle that a state shall not tax a foreign company more than it taxes its own companies. A *Wardair*-like negative implication concerning WWCR which arises from this generality is impossible.[5]

Also cloaked in generality is the Board's fourth factor that the Board asserts would preclude a dormant commerce clause analysis: the absence of enacted congressional legislation prohibiting or restricting the use of WWCR to foreign-based multinationals.

Apparently the Board concedes the trial court's finding that there was no evidence there has ever been a vote in a congressional committee or in Congress itself on legislation prohibiting the use of WWCR. And the senior career official in the Department of Treasury for WWCR matters during much of the 1970's and 1980's, George N. Carlson, testified that none of the proposed legislation dealt solely with WWCR as to foreign-based enterprises. It is also true, as reiterated in *Container,* that " 'Congress has long debated, but has not enacted, legislation designed to regulate state taxation of income.' " (463 U.S. at pp. 196-197 [77 L.Ed.2d at p. 573], quoting Mobil Oil Corp. v. Commissioner of Taxes, supra, 445 U.S. at p. 448 [63 L.Ed.2d at p. 528].)

The problem with this factor is that in trying to assign a specific reason to legislative inaction, we must enter the realm of pure speculation. It is difficult enough trying to ascertain legislative intent when a statute has been enacted, but trying to find meaning in legislative silence is about as difficult as hearing sound in a vacuum.

That brings us to the Board's fifth factor and the only one that specifically concerns the application of WWCR to foreign-based enterprises.

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[5]Our determination is supported by the fact that less tax-specific treaties such as the FCN Treaties contain a comparable nondiscrimination clause. (23 Columbia Journal at p. 471.)

In 1975 the executive branch negotiated an income tax treaty with the United Kingdom containing a provision — article 9(4) — that would have prohibited the states' application of WWCR to U.K.-based corporate groups. The United States Senate ratified the treaty only after article 9(4) was effectively removed through a reservation by Senator Church. The Board contends this senatorial action "was a significant indication of federal policy to let the states continue to use WWCR." Again, the Board simply reads too much into too little.

The Church reservation to article 9(4) was defeated in the Senate Foreign Relations Committee and again on the Senate floor. However, the treaty with article 9(4) included received a favorable full Senate vote of only 49 to 32, falling 5 votes short of the two-thirds majority needed for ratification. When the Church reservation was resurrected without a vote and the controversial article was effectively removed, the Senate then provided its constitutional imprimatur.

In light of these Senate tallies, it is difficult to see a congressional policy permitting states to use WWCR. Moreover, it appears that some of the senatorial opposition to article 9(4) was rooted not in the substance of the article but in the procedural wariness of addressing the problem through patchwork treaties rather than through comprehensive legislation.

The Board asks reasonably why no tax treaty subsequent to the U.S.-U.K. Tax Treaty has included a provision similar to article 9(4). The Board's answer is that the Senate action on 9(4) indicated a congressional policy permitting states to use WWCR. Our answer is that the constitutional high hurdle of treaty ratification and a treaty's piecemeal approach to the problem render a resolution via the treaty process ineffectual. We simply fail to see how three majority votes in the Senate essentially approving article 9(4) can be transmogrified into a *congressional policy* of disapproval.

Whether the Board's five factors are analyzed individually or collectively, they fall far short of establishing under *Wardair* an affirmative federal policy permitting California's use of WWCR. To the court in *Wardair* the factors there — an international

Convention, an international Resolution, and more than 70 post-Convention agreements, including the U.S.-Canadian Agreement and the course of conduct thereunder by its two federalist signatories — made it "abundantly clear" that the federal government had "affirmatively decided to permit the States to impose these sales taxes on aviation fuel." (477 U.S. at pp. 9-12 [91 L.Ed.2d at pp. 10-12].) That clarity was grounded in the close connection between those factors and the tax at issue, as the factors specifically discussed the subject matter of and taxes inextricably related to the tax at issue, or actually encompassed the type of tax at issue.

As we have seen, there is no similar connection between the factors cited by the Board and the WWCR taxation method at issue here. Only one of the Board's factors specifically addresses WWCR, and it does so in a manner that is at best neutral in respect to the Board's position. Interestingly, the court in *Container* had before it many of the same factors upon which the Board relies including the Senate action on the U.S.-U.K Treaty, and nevertheless engaged in a dormant commerce clause analysis. (463 U.S. at pp. 185-197 [77 L.Ed.2d at pp. 566-573].) Put most succinctly, while the court in *Wardair* was dealing with hard and specific evidence, we have been dealt "Five Easy Pieces." We proceed to a foreign dormant commerce clause analysis, applying the foreign dormant commerce clause test of *Japan Line* and *Container*.

1. *The Enhanced Risk of Multiple Taxation.*

This consideration need not detain us long. All of the elements of double taxation involved in *Container* are also involved here. (463 U.S. at pp. 189-193 [77 L.Ed.2d at pp. 568-571].) But *Container* rejected those elements, reasoning that they were not "inevitable" and that resorting to the AL/SA method would not guarantee their demise. (*Ibid.*) We can discern no constitutionally significant differences between domestic-based and foreign-based multinational corporations concerning the enhanced risk of multiple taxation: in neither case is double taxation inevitable. Following the precedent of *Container*, we find California's use of

WWCR as to foreign-based multinationals is not unconstitutional on this ground.

2. *Whether California's Application of WWCR to Foreign-Based Unitary Groups May Impair Federal Uniformity in an Area Where Federal Uniformity Is Essential and Prevents the Federal Government From Speaking With One Voice in International Trade.*

A. Foreign Policy Implications

The first issue to consider is whether California's application of WWCR to foreign-based unitary groups implicates foreign policy issues which must be left to the federal government. (*Container, supra*, 463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572]; see also *Japan Line, supra*, 441 U.S. at pp. 448, 453 [60 L.Ed.2d at pp. 347, 350].) We think that it does.

According to *Container*, "[t]he most obvious foreign policy implication of a state tax is the *threat it might pose* of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." (Emphasis added, 463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) Every single nation in the industrialized western world has sent letters to the United States government protesting the use of WWCR by American states. Many of these protests have also been directed to California. Among the most vigorous of these remonstrators has been Canada, by far the United States's largest trading partner, and Britain, this country's largest foreign investor. These protests have been sharp, frequent, and incessant over a number of years. There was also evidence that no other taxation issue had ever led foreign governments to deal directly with American states. Even high-placed officials of the Board acknowledged awareness of this international outcry. (See 20 Santa Clara L.Rev. at pp. 125-126.)

And it is not just talk. The ultimate test of diplomatic sincerity — watch what they do, not what they say — has been met here. In 1985, Britain passed retaliatory legislation withdrawing a tax advantage for U.S.-based corporations doing business in both Britain and a unitary tax state. Though Britain stopped short of pulling the procedural trigger to fully implement this legislation,

the law had a retroactive provision that impelled many American companies into preimplementation compliance. Moreover, Britain cancelled a trade mission to Florida because that state applied WWCR to foreign-based multinationals. And there were other similar cancellations. There was also evidence the United States has had problems in negotiating treaties because of objections to WWCR.

The Board claims Britain has orchestrated the international outcry and passed a disingenuous piece of "retaliatory" legislation that does not retaliate. However, some nation has to take the lead and the often-noted "special relationship" between Britain and the United States makes Britain the obvious choice for conductor. We doubt that every industrialized country in the western world would have joined the symphony if there were not truly a significant problem. In fact, a committed leader is more likely, not less likely, to be genuinely devoted. As to the allegedly devious legislation, Britain, the largest foreign investor in the United States, stood to lose disproportionately if America deemed that legislation completely unfounded. Many American companies operating in Britain did not believe such legislation was merely for show. Moreover, the legislation was introduced "back-bench," that is, by the opposition party, and nevertheless passed unanimously — extraordinary legislative feats according to the bill's author.

Our views are buttressed by analyzing the three general factors identified in *Container* that "might justifiably lead to significant foreign retaliation." (463 U.S. at pp. 194-195 [77 L.Ed.2d at p. 572].) The first factor is whether California's use of WWCR creates an automatic asymmetry in international taxation operating to the foreign-based multinational's disadvantage. Because no other country in the world uses WWCR, domestic-based multinationals do not face this taxation method abroad. And while both domestic and foreign-based multinationals are subjected to the method if they do business in an American jurisdiction that employs it, the administrative burdens of compliance, as we shall see, fall much harder on the foreigner.

The second general factor identified in *Container* inquires whether the legal incidence of the tax falls on a domestic

corporation or a foreign one. (463 U.S. at p. 195 [77 L.Ed.2d at p. 572].) This factor was of significant importance in *Container*, being noted at four places in the opinion. (*Id.*, at pp. 188-189, 195, including fns. 26, 32 [77 L.Ed.2d at pp. 568-569, 572].) We face here the precise issue reserved in *Container*: "the constitutionality of combined apportionment with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." (*Id.*, at p. 189, fn. 26 [77 L.Ed.2d at p. 568].) *Container* carefully noted that the tax there was imposed on a domestic corporation, "not on a foreign entity as was the case in *Japan Line*," and that "[a]lthough, California 'counts' income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation." (*Id.*, at p. 195 [77 L.Ed.2d at p. 572].) *Container* also recognized "that the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests." (463 U.S. at p. 195, fn. 32 [77 L.Ed.2d at p. 572].)

Here, California's taxation method of WWCR falls directly on a domestic corporation with a foreign parent (Barcal) and directly on a foreign corporation with a foreign parent and foreign subsidiaries (BBI). As we have seen, foreign governments are none too happy about this state of affairs. The governments of Britain and Canada have expressed their displeasure to this court through their amici curiae briefs.

Proponents of the worldwide unitary tax method cannot dispel foreigners' concerns by arguing that it is really the United States subsidiary or operation that bears the tax burden. The premise of the unitary tax system is that it is unrealistic geographically to isolate income derived from the intangible flow of value among the parts of a unitary business. Similarly, then, it is unrealistic to isolate the tax payments necessitated by that system: the incidence of taxation falls on the entire business, including the foreign parent. (See 23 Columbia Journal at p. 466.)

That brings us to the third general factor identified in *Container* as bearing on the risk of foreign retaliation: whether the tax

burden is more a function of California's WWCR tax rate or its allocation method. (463 U.S. at p. 195 [77 L.Ed.2d at p. 572].)

Foreign-based corporate groups incur significantly greater administrative costs to comply with California's WWCR system than do their domestic-based counterparts; in fact, all of the trial witnesses agreed that literal compliance with the system was cost-prohibitive for the foreign groups.[6] (See Comptroller General Report, *Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving*, 3, GAO/GGD-82-38 (1982) [hereafter, GAO Report].)

In a nutshell, this distinction between domestic and foreign-based multinationals is a result of the following: while domestic-based multinationals keep most of their records in English, in United States currency and in accord with United States accounting principles, the same cannot be said for multinationals based abroad. (GAO Report at p. 39.) For the foreign parent, some of the information may not be available because different nations use different accounting methods. Obviously, the information that does exist is not always in the language, in the currency, and in accord with the principles just noted. Substantial costs are incurred in obtaining the necessary information and translating and transforming it to these modes. (See 20 Santa Clara L.Rev. at pp. 143-144; 23 Columbia Journal at p. 471.)

The administrative nightmare for the foreign-based multinational is aptly demonstrated here. In 1977, BBI, a Britain-based company, was engaged in business directly or through subsidiaries in approximately 55 countries. During this time, BBI had an interest sufficient for California unitary group purposes, in more than 70 subsidiaries operating in approximately 34 countries outside Britain. Two of those subsidiaries were organized and

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[6]The Board contends the trial court should have excluded all evidence on cost of compliance because plaintiffs failed to adequately raise the issue in administrative proceedings. We disagree. Plaintiffs' original and supplemental protests raise the compliance issue as part of their overall constitutional challenge. Moreover, the Board was apprised of this issue in correspondence during the administrative process.

operated in the United States: Barcal and Barclays Bank of New York (BBNY). In addition to owning BBI and BBI's subsidiaries, BBL, the Britain-based ultimate corporate parent, owned a sufficient interest for California unitary purposes in over 140 subsidiaries that operated outside the United States. All told then, the Barclays unitary group consisted of over 220 subsidiaries (including subsidiaries of subsidiaries)operating in some 60 countries, but of these only BBI, Barcal, and BBNY, did business in the United States.

Using the Board's own figures, only 1.5 percent of the income generated by the Barclays group worldwide in 1977 can be attributed to California. Even accounting for the BBNY activity, this means that over 98 percent of the Barclays group's income in 1977 had its source outside the United States. According to witnesses at trial, it would cost millions of dollars for Barclays to establish and maintain the global system necessary to literally comply with California's WWCR tax method. (The figures ranged from $6.4 million to $7.7 million to establish the system, and from $2 million to $3.8 million a year to maintain it.) And note that Barclays, unlike many other foreign multinationals, at least speaks the same language as the California taxing authorities.

That it is California's allocation method rather than its tax rate that is the primary source of difficulty becomes readily apparent when these kinds of circumstances are viewed by foreign entities steeped in the AL/SA tradition. Foreign anger is even more understandable in light of the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations based on the AL/SA method. (See 23 Columbia Journal at pp. 459-462; 20 Santa Clara L.Rev. at pp. 153-154.)

The trial court deemed these costs of compliance sufficient to invalidate WWCR as an unconstitutional discrimination against foreign commerce — i.e., as a breach of one of the original four tests set forth in *Complete Auto* (430 U.S. 274 [51 L.Ed.2d 326]). While we do not here use costs alone to constitutionally invalidate the use of WWCR (see *Bibb v. Navajo Freight Lines* (1959) 359 U.S. 520, 526 [3 L.Ed.2d 1003, 1008]), this legal

analysis by the trial court — based upon a factual foundation of substantial evidence — demonstrates just how serious the administrative burden can be for the foreign entity.

The Board argues that literal compliance is a nonissue because regulations have been adopted by which a foreign-based multinational can use reasonable approximations to figure its California tax. (Cal. Code Regs., tit. 18, § 25137-6; Rev. & Tax Code, § 25137.) These approximations, according to the Board, can be derived from annual reports and other data that are already publicly available. (See 23 Columbia Journal at p. 472.)

There are several problems with the Board's argument. The Board decides whether to allow a foreign entity the route provided by regulation 25137-6, and such discretion is a powerful instrument in light of the cost-prohibitive alternative of literal compliance. Moreover, California state tax authorities have at least once threatened to impose penalties for failure to produce detailed information needed to apportion income, even though the British-based company involved claimed the information was confidential under Britain's national security laws. (See *EMI Ltd. v. Bennett* (N.D.Cal. 1982) 560 F.Supp. 134; *Capitol Industries — EMI, Inc. v. Bennett* (9th Cir. 1982) 681 F.2d 1107, 1110-1111; 23 Columbia Journal at p. 472.) These tax authorities cannot maintain on the one hand that reasonable approximations derived from already publicly available data are sufficient, and on the other hand demand under sanction more detailed information that is not readily available or even producible. Logically, detailed information on payroll, property, and sales is needed to apply the WWCR formula in an uncapricious manner. But more fundamental is why a state which has so little faith in the AL/SA method would so willingly embrace another method that is based on approximations derived from very general data? In light of these observations, the practical availability of the reasonable approximation approach is seriously open to question.

In contrast to *Container* then, we do not have to speculate on whether the taxation method at issue may offend our foreign trading partners and lead them to retaliate against the nation as a whole. (463 U.S. at p. 194 [77 L.Ed.2d at p. 572].) They are offended; they have retaliated. And the three general factors

identified in *Container* that might justifiably lead to significant retaliation — asymmetry, upon whom the tax falls, and tax rate versus allocation method — are all present in this case. (*Id.*, at pp. 194-195 [77 L.Ed.2d at p. 572].)

Also in marked contrast to *Container* stands the amicus curiae brief from the federal executive branch opposing California's application of WWCR to foreign-based corporate groups. That brief reiterates many of the points noted above and delineates an executive branch policy we will discuss below. We are mindful of *Container's* observation that in the context of the foreign commerce clause the foreign policy nuances of the United States are much more the province of the executive and the Legislature than of the judiciary. (463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].)

B. Clear Federal Directive

That brings us to the other avenue identified in *Container* by which a state tax will violate the "one-voice" standard: if the tax violates a clear federal directive. (463 U.S. at p. 194 [77 L.Ed.2d at pp. 571-572].) As this consideration is an integral component of the dormant commerce clause test, obviously such a directive is not synonymous with an affirmative federal policy precluding dormant commerce clause analysis. (*Id.*, at pp. 193-194 [77 L.Ed.2d at p. 571].)

In dealing with this issue, the court in *Container* looked for specific indications of congressional intent after noting that no amicus brief from the executive branch had been filed. (463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].) Examining much of the same evidence relied on by the Board here to preclude a dormant commerce clause analysis, *Container* did not find any such indications and concluded that California's application of WWCR to domestic-based corporate groups was not preempted by federal law or fatally inconsistent with federal policy. (*Id.*, at pp. 196-197 [77 L.Ed.2d at p. 573].)

Like the court in *Container*, the trial court in this instance found "no Congressional expression either way on this subject."

Our earlier discussion as to why *Wardair* does not preclude a dormant commerce clause analysis supports this finding.

However, the trial court found the evidence unequivocal "that the executive branch all along, under three administrations since the WWCR problem in the present context became known, has steadfastly adhered to a policy of use of the arms length/separate accounting (AL/SA) method and not WWCR, both as to the States and the Federal Government." In the context presented here, we agree with the trial court.

George Carlson, who was the Treasury Department's (the executive department charged with formulating tax policy) senior career official for WWCR issues during most of the 1970's and 1980's, testified regarding the executive branch's policy on WWCR application to foreign-based corporate groups. That policy was officially pronounced in 1975 when the U.S.-U.K. Tax Treaty was signed, and essentially proscribed such an application while advocating an accounting restriction to the "water's-edge" of the United States. The genesis of the policy can be found in Treasury Department studies confirming complaints from foreign governments about increased risks of double taxation, disproportionate administrative burdens, and possible retaliation. Additionally, those studies found that WWCR in a foreign context was interfering with the federal government's foreign commercial policy and its ability to negotiate bilateral tax treaties. In short, the Treasury Department — again, the executive department charged with formulating the executive branch's tax policy — concluded that WWCR was an irritant in our foreign commerce relations.

This executive policy remained constant through four presidential administrations, starting when negotiations on the U.S.-U.K. Tax Treaty began, to the point when this case was litigated. And though there was a change in political party of the executive during this time, there was no change in policy: the executive branch did not want WWCR applied to foreign-based corporate groups.

Negotiations on the U.S.-U.K. Tax Treaty began during President Nixon's administration.

That treaty, with article 9(4) included, was signed during President Ford's tenure.

President Carter's Secretary of the Treasury, Michael Blumenthal, in a 1977 letter to Martin Huff, then the executive director of the Board, stated: "The unitary apportionment system is inconsistent with accepted tax treaty policy which prohibits one country from taxing the business profits of an enterprise of the other unless that enterprise is engaged in business through a permanent establishment in the first country. . . . [¶] . . . The arm's length standard is the internationally accepted approach." And President Carter's Assistant Secretary of the Treasury for Tax Policy, Donald Lubick, explained the administration's position to both houses of Congress in March and June of 1980. Lubick emphasized that WWCR application to foreign-based corporate groups was the preeminent concern, citing the firmly-documented problems of foreign policy interference, double taxation, administrative burdens, and possible retaliation.

Faced with a deluge of complaints from all of our major trading partners and his patience exhausted by the failure of the states to resolve the WWCR problem voluntarily, President Reagan in 1985 publicly issued a directive on the matter. He instructed the Attorney General to pursue through litigation and the Secretary of the Treasury to pursue through legislation and where appropriate, through treaty amendment, the federal policy that multinational corporations be taxed by states only on income derived from the United States and not on income derived from foreign subsidiaries. Under the aegis of that directive, Secretary of State Schultz in early 1986 wrote to Governor Deukmejian urging him to support efforts to end California's use of WWCR. Not only did this letter explain that it was the long-standing policy of the United States to follow the AL/SA method, which was also the international standard, but that, "[y]our state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states;" furthermore, the letter pointed out that "[t]he worldwide unitary issue has seriously complicated our economic relations with many of our closest allies." California passed the "water's-edge" legislation a few months later.

On this record we feel confident in saying that the executive branch has spoken clearly. Through that branch, the policy of the United States since the WWCR problem in the present context arose in the 1970's has been established: WWCR is not to be applied to foreign-based corporate groups — those groups are to be taxed by the states only on income derived from the United States.

Naturally, the question arises as to whether the executive branch alone can establish national policy in the field of foreign commerce or does it need the concurrence of the legislative branch?

Undoubtedly, the legislative branch can establish national policy in the field of foreign commerce without the concurrence of the executive branch. Specifically, the federal Constitution grants Congress this power (U.S. Const., art. I, § 8, cl. 3).

Does the same obtain for the executive branch? In the steel industry seizure case of Youngstown Sheet & Tube Co. v. Sawyer (1952) 343 U.S. 579 [96 L.Ed. 1153], Justice Jackson wrote a concurring opinion analyzing the scope of presidential power. (343 U.S. at pp. 634-656 [96 L.Ed. at pp. 1198-1210].) It has been said that Jackson's opinion "brings together as much combination of analysis and common sense as there is in this area, . . ." (See Dames & Moore v. Regan (1981) 453 U.S. 654, 661 [69 L.Ed.2d 918, 929].) In that opinion, Jackson set forth the following tripartite framework as a guide in resolving issues involving presidential power: "1. When the President acts pursuant to an express or implied authorization of Congress, his authority is at its maximum, for it includes all that he possesses in his own right plus all that Congress can delegate. In these circumstances, and in these only, may he be said (for what it may be worth) to personify the federal sovereignty . . . . A seizure executed by the President pursuant to an Act of Congress would be supported by the strongest of presumptions and the widest latitude of judicial interpretation, and the burden of persuasion would rest heavily upon any who might attack it. [¶] 2. When the President acts in absence of either a congressional grant or denial of authority, he can only rely upon his own independent powers, but there is a zone of twilight in which he and Congress may have

concurrent authority, or in which its distribution is uncertain. Therefore, congressional inertia, indifference or quiescence may sometimes, at least as a practical matter, enable, if not invite, measures on independent presidential responsibility. In this area, any actual test of power is likely to depend on the imperatives of events and contemporary imponderables rather than on abstract theories of law. [¶] 3. When the President takes measures incompatible with the expressed or implied will of Congress, his power is at its lowest ebb, for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter. . . . Presidential claim to a power at once so conclusive and preclusive must be scrutinized with caution, for what is at stake is the equilibrium established by our constitutional system." (Fns. omitted, 343 U.S. at pp. 636-638 [96 L.Ed. at pp. 1199-1200].)

Based upon our previous analysis, the executive action here aligns with Justice Jackson's second category. And as noted by Justice Jackson, it is the imperative of events and contemporary imponderables rather than abstract theories of law that primarily guides our review.

We begin by emphasizing the field in which the executive branch has acted: foreign policy. That is a field in which the executive possesses substantial power of its own. (See United States v. Curtiss-Wright Export Corp., supra, 299 U.S. at pp. 319-320 [81 L.Ed. at pp. 262-263]; United States v. Belmont, supra, 301 U.S. 324 [81 L.Ed 1134]; United States v. Pink (1942) 315 U.S. 203 [86 L.Ed. 796]; *Container, supra*, 463 U.S. at pp. 165-166 [77 L.Ed.2d at p. 553]; U.S. Const., art. II, §§ 1, 2.) Although the Constitution grants to Congress the power to regulate commerce with foreign nations, the executive's rightful power in the foreign policy arena inextricably involves international commercial relations. *(Container, supra.)*

Particularly is this true in this era of increasingly "globalized" and rapidly changing economic forces, and the beginnings of economic displacement of military competition in big power relations. The rapidity with which global changes in economic structure are occurring places an imperative on the exercise of swift and effectual national power, the kind of power most

suitably exercised by the executive. Recall *Wardair*'s reiteration that "'[i]n international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power.'" (477 U.S. at p. 8 [91 L.Ed.2d at p. 9], quoting *Japan Line, supra*, 441 U.S. at p. 448 [60 L.Ed.2d at p. 347], quoting Board of Trustees v. United States, supra, 289 U.S. at p. 59 [77 L.Ed. 1025].)

If Congress were to enact legislation or take some other affirmative action contrary to the executive branch policy, that would most likely be the end of the matter. But Congress must act as a consensual body before a legislative policy can be discerned. Before that happens, the legislative branch, in contrast to the executive branch, resembles more a cacophony than a chorus of voices, each legislator having his or her own reason for speaking. As detailed earlier, we discern no congressional policy regarding the states' use of WWCR.

We are mindful of the Board's concern about unbridled executive power and about national policy being nothing more than what the executive says it is. Again, however, we must emphasize that we are dealing with a critical foreign policy issue on which the executive has affirmatively acted and the Congress has not. Nor would it have been difficult for the Congress to act: one simple sentence in a piece of legislation, a treaty, or a resolution would have sufficed.

The evidence here reveals that as soon as the problem of WWCR in an international context arose, executive departments began studying the issue. Those studies confirmed the validity of the complaints from foreign governments and culminated in the official and public expression of executive branch policy in 1975 with the signing of the U.S.-U.K. Tax Treaty. In a nutshell, that policy sought the elimination of WWCR as applied to foreign-based corporate groups, and an accounting restriction to the "water's-edge" of the United States. The policy has never wavered though the party affiliations of the administrations continuing it have. In fact, through the years, the policy has grown stronger: the Reagan administration sought to eliminate WWCR

as applied not only to foreign-based multinationals, but to domestic-based ones as well.

Public expressions of the executive policy have been made continuously since the mid-1970's. Even the executive director of the Board was explicitly informed by President Carter's Secretary of the Treasury in 1977 that the unitary apportionment system was inconsistent with accepted tax treaty policy — i.e., with the AL/SA method. And one cannot doubt the clarity of the executive's position.

In this context, it is unnecessary to fret about national policy being formulated through executive whim. Found here is a clear, continuous, and thoroughly-grounded policy developed by the executive branch in the face of congressional inertia and inaction, and directly involving an issue — foreign policy — to which great deference to the executive has traditionally been given. (See United States Curtiss-Wright Export Corp., supra, 299 U.S. at pp. 319-320 [81 L.Ed. at pp. 262-263]; Container Corp. v. Franchise Tax Bd., supra, 463 U.S. at pp. 195-196 [77 L.Ed.2d at pp. 572-573].) This context also strikes the proper balance between the purposes of the commerce clause — to avoid "economic balkanization," promote free trade and prevent individual states from working to the detriment of the nation as a whole — and the legitimate interest of the states in exercising their taxing power. (See Boston Stock Exchange v. State Tax Comm'n (1977) 429 U.S. 318, 328-329 [50 L.Ed.2d 514, 523-524]; National Meat Ass'n. v. Deukmejian (9th Cir. 1984) 743 F.2d 656, 659.) While we realize that a state's power to tax is bottomed on a broad base, we cannot ignore that California's application of WWCR to foreign-based corporate groups directly affects international relations. (See Hines v. Davidowitz, supra, 312 U.S. at p. 68 [85 L.Ed. at pp. 587-588]; Zschernig v. Miller (1968) 389 U.S. 429 [19 L.Ed.2d 683]; Bethlehem Steel Corp. v. Board of Commissioners (1969) 276 Cal.App.2d 221; Amarel v. Connell (1988) 202 Cal.App.3d 137.)

We must also emphasize that our determination has little to do with the technical merits of the WWCR method in the abstract. Theoretically, that method may very well be a superior one were it to be applied fairly by nations around the globe. But the

international community is presently enmeshed in the tradition of separate accounting, a tradition largely engendered through American efforts. When an American state in isolation employs a method which radically departs from that tradition and which demands an accounting of foreign corporations that have nothing to do with the state or with the United States for that matter, the adverse implications for American foreign policy are not hard to imagine.

We hold that California's unitary tax method (worldwide combined reporting, WWCR) as applied to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal Constitution because it not only implicates foreign policy issues which must be left to the federal government but violates a clear federal directive as well. (*Container, supra,* 463 U.S. at p. 194 [77 L.Ed.2d at p. 571].)

The Board argues that even if this application of WWCR is unconstitutional under the foreign commerce clause today, such a determination is irrelevant to its constitutionality in 1977. We disagree for two reasons.

First, we have determined the trial court was correct in finding that the executive branch since 1975 has clearly and consistently opposed applying WWCR to foreign-based corporate groups. Second, and more importantly, the "one-voice" standard of *Japan Line* and *Container* does not depend on the outcome of events for its application. In applying that test, the courts inquire whether a state tax "*may* impair federal uniformity in an area where federal uniformity is essential" (emphasis added, *Japan Line, supra,* 441 U.S. at p. 448 [60 L.Ed.2d at p. 347]); and they analyze "the *threat* [the tax] *might* pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole" by employing general standards to see if the tax "*might* justifiably lead to significant foreign retaliation." (Emphasis added, *Container, surpa,* 463 U.S. at p. 194 [77 L.Ed.2d at p. 572.) In short, the judiciary asks whether the probability of justifiable, adverse foreign response and actions is too strong to permit the state tax to stand. This judicial application of the foreign commerce clause thus aligns with the underlying premise of the clause: to "commit[ ] to the exclusive authority of the Federal

Government the regulation of those aspects of foreign commerce that *by their very nature* 'necessitate a uniform national rule.'" (Emphasis added, Wardair Canada v. Florida Dept. of Revenue, supra, 477 U.S. at p. 18 [91 L.Ed.2d at p. 16] [dis. opn. of Blackmun, J.], quoting *Japan Line, supra*, 441 U.S. at p. 449 [60 L.Ed.2d at p. 348].)

As the trial court aptly noted in this regard, "[t]his case factually demonstrates as extreme an example of predictable international consequences stemming from a local tax as can be conceived." Succinctly stated, the Board required the Britain-based Barclays group, which derived over 98 percent of its income from business activity outside the United States, to supply detailed accounting information on all of its more than 200 subsidiaries operating in some 60 countries because the group did a little over 1 percent of its business in California. In light of the custom of nations making AL/SA the international standard, the radical differences between AL/SA and WWCR, and the distinctions between this case and *Container*, a direct, adverse impact on foreign affairs was inevitable. The international furor that resulted was justified and therefore entirely predictable.

The Board unnecessarily worries whether such a holding would subject a state's power to tax to the mercy of a foreign government's vocal chords. Our opinion has made clear, substantially more than mere complaints are involved in this case. The essentials of the dilemma were concisely summarized by one witness at the U.S.-U.K. Tax Treaty hearings: "To permit them [the states] to roam the world threatening U.K. based companies having no permanent establishment in the U.S., demanding information which the U.S. would have no treaty right to demand, and generally acting like a bull in the international china shop, is unbecoming to the dignity of the U.S., to the placidity of its relations with those countries with which it solemnly negotiates treaties, and accomplishes no purpose necessary for the protection of the revenue of the taxing states." (23 Columbia Journal at p. 467.)

Having decided that California's application of WWCR (Rev. & Tax. Code, § 25101) to foreign-based unitary groups is unconstitutional under the foreign commerce clause of the federal

Constitution, it is unnecessary for us to consider the plaintiffs' due process challenge.

The judgment is affirmed. *(CERTIFIED FOR PUBLICATION.)*

EVANS, J.*

We concur:

PUGLIA, P.J.

DAVIS, J.

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* Assigned by the Chief Justice.

APPENDIX C

SUPERIOR COURT OF CALIFORNIA, COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LIMITED,
a Corporation of the Country of England,
Plaintiff,
vs.
FRANCHISE TAX BOARD,
an Agency of the State of California,
Defendant.

BARCLAYS BANK OF CALIFORNIA,
a California corporation,
Plaintiff,
vs.
FRANCHISE TAX BOARD,
an Agency of the State of California,
Defendant.

No. 325059
No. 325061
(Consolidated for Purposes of Trial)

ENDORSED:
Filed August 20, 1987

JOYCE RUSSELL SMITH, CLERK
By S. GODFREY, Deputy

STATEMENT OF DECISION

The Court hereby adopts in full its "INTENDED DECISION" of June 16, 1987, and hereby files it as attached hereto, as the Court's "STATEMENT OF DECISION".

DATED: August 20, 1987.

GEORGE E. PARAS
Judge of the Superior Court
Pro Tem

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTC.,
a Corporation of the Country of England,
Plaintiff,
vs.
FRANCHISE TAX BOARD,
an agency of the State of California,
Defendant.

BARCLAYS BANK OF CALIFORNIA,
a California corporation,
Plaintiff,
vs.
FRANCHISE TAX BOARD,
an agency of the State of California,
Defendant.

No. 325059
No. 325061
(Consolidated for Purposes of Trial)

ENDORSED:
Filed June 16, 1987

JOYCE RUSSELL SMITH, CLERK
By S. GODFREY, Deputy

INTENDED DECISION

I
STIPULATED FACTS

Pursuant to written stipulation of the parties (Exhibits 1 and 2), the facts therein stipulated are found to exist. Said stipulations are attached hereto as Schedules 1 and 2 respectively. Additional findings of fact on disputed matters are made during the course of this Intended Decision.

II
JURISDICTIONAL ISSUE

Defendant Franchise Tax Board (FTB) renews its jurisdictional claim (denied on a motion in limine [RT Page 136-138] at the outset of the trial) that because Plaintiffs assertedly failed to mention in their protest (the procedural equivalent here of a "claim") that a basis thereof was unconstitutionality deriving from interference with the *Federal Executive Branch's* conduct of foreign affairs, they are precluded from relief on that basis at trial. This issue is again resolved against Defendants on two grounds; first, the protest and proceedings thereon did give adequate notice, and second, if the tax as here applied is unconstitutional on any ground the FTB did not have jurisdiction so to adjudicate it, hence the presentation of such a specific claim would have been a futile act. This ruling is fortified by *Park 'N Fly of San Francisco, Inc. v. South San Francisco* (1987) 188 Cal App 3d 1201.

FTB's request for judicial notice of Friendship, Commerce and Navigation (FCN) Treaties with France, the Federal Republic of Germany, Japan, and the Netherlands is granted.

III
JAPAN LINE, CONTAINER, AND WARDAIR CASES

Three U. S. Supreme Court Cases decided within the past eight years are absolutely vital to the position of both parties. They are *Japan Lines Ltd. v. County of Los Angeles* (1979) 441 U.S. 434, *Container Corporation of America v. Franchise Tax Board* (1983) 463 U.S. 159, and *Wardair Canada v. Florida Department of Revenue* (1986) 477 U.S. ____; 106 S.Ct. 2369. Before I can rule on the various contentions it seems to me

essential that I analyze and offer my interpretation of each decision, both as it affects this case and as it affects the other two. I do this with unqualified respect for contrary interpretations by the parties and by others. We are in a highly complex area of constitutional law, so complex that it's exposition in a given case necessarily occasions varying nuances of judicial expression and intendment, not all of which are or can be perceived identically by every reader and some of which are themselves at times not totally consistent. Even so, it is hopeless to undertake a resolution of the issues here without a basic exposition of the legal significance of these three cases as seen by this Court.[1]

A. *JAPAN LINE*

The first case in the trilogy involved an ad valorem property tax by Los Angeles County on large containers owned and used by Japanese companies in connection with their international marine shipments of goods strictly in foreign commerce. The containers only "stopped off" for short periods at foreign (to Japan) ports like Los Angeles in the course of their international journey. The Supreme Court invalidated the tax on foreign commerce constitutional grounds.

Initially it is notable that the Court's analysis did not involve due process and the 14th Amendment (441 U.S. at 439, FN. #3); thus it can be of no help to us here as to Plaintiff's due process claim. Nor did it address the question of participation of the Executive Branch in the conduct of foreign affairs; thus, it is of no assistance in resolving that issue either.

The Court might have grounded its holding on the common law "Home Port Doctrine" (*Hays v. Pacific Mail S. S. Co.*, (1985) 17 How. 596), but expressly refused to do so (441 U.S. at 442-444), saying: "The question here is a . . . narrow one, that is, whether instrumentalities of commerce that are owned, based, and registered abroad, and that are used exclusively in international com-

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[1]It goes without saying that *Japan Line*, *Container* and *Wardair* are not the only authorities affecting this decision. The multitude of other cases have been studied and considered, and appropriately enter into the result.

merce, may be subjected to apportioned ad valorem property taxation by a State." Rather the court moved directly into the Commerce Clause, Article I Section 8, Cl. 3 of the Federal Constitution. It reviewed its own holdings regarding state taxes in the interstate commerce area, including "instrumentalities of interstate commerce", and reiterated the applicable four pronged test for determining constitutionality (substantial nexus, fair apportionment, non-discrimination, and fair relation) as enunciated in *Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, and *Washington Revenue Dept. v. Association of Wash. Stevedoring Cos.* (1978) 435 US 734. Rejecting the taxing authority's contention that the Commerce Clause analysis is identical in a foreign as well as an interstate context, it stated that "[w]hen construing Congress' power to regulate commerce with foreign nations', a more extensive constitutional inquiry is required." (441 US at 446) It then enunciated the now firmly established and accepted two additional criteria, enhanced risk of multiple taxation and potential impairment of federal uniformity in areas in which such uniformity is essential (441 US at 446 to 451).

As to the first criterion, the Court stressed the absence of any authoritative tribunal capable of ensuring against a double tax burden in the international area, in contrast with its own power so to ensure in the interstate area. It indicated the foreign country of domicile of an instrumentality of commerce "*may* have the right *consistently with the custom of nations* to impose a tax on its full value. [fn omitted] If a state should seek to tax the same instrumentality on an apportioned basis, *multiple taxation inevitably results.*" (emphasis added) (441 US at 447). "A . . . state tax, even though 'fairly apportioned' . . . *may* subject foreign commerce to the *risk* of a double tax burden to which (domestic) commerce is not exposed, and which the Commerce Clause forbids' ". (emphasis added) (441 US at 448). The Court pursued this point by indicating the ad valorem tax created more than the *risk* of double taxation; based on a stipulation and a trial court finding, Japan in fact taxed the same items at full value, hence there was an undeniable double tax (thus the Court did not elaborate on what circumstances would cause the mere *risk* of double tax to come into play constitutionally) (441 US at 452, incl. FN 17). To the assertion that it is Japan's levy that creates

the double tax, not California's (Los Angeles County's), the Court responded with "California's tax, however, *must be evaluated in the realistic framework of the custom of nations.* Japan has the right and the power to tax [the] containers at their full value; nothing could prevent it from doing so." (emphasis added) (441 U.S. at 454.) Similarly it rejected a claim that since Congress has not acted a State may act, in favor of a Dormant Commerce Clause concept, stating "California may not tell this nation or Japan how to run their foreign policies" (441 U.S. at 454-455). Finally, the Supreme Court distinguished *Moorman Mfg v. Bair* (1978) 437 U.S. 267, on the basis primarily that it concerned interstate commerce, but confirmed in the process "that the Commerce Clause 'does not call for mathematical exactness nor for the rigid application of a particular formula; only if the resulting valuation is palpably excessive will it be set aside.' " (441 U.S. at 455).

As to the second criterion, the Supreme Court stressed the concept that the Foreign Commerce power of Congress is greater than its Interstate Commerce power, emphasizing "the need for uniformity in treating with other nations" and "the framers overriding concern that 'the federal government must speak with one voice when regulating commercial relations with foreign governments' " (441 U.S. at 448-449). The Court gave illustrations of how the subject tax *may* frustrate federal uniformity, as by resulting international disputes over reconciling apportionment formulae, by retaliation from other nations to the detriment of the United States as a whole, and by other states of the United States than California also taxing the same subject, "a result which would plainly prevent this nation from 'speaking with one voice' in regulating foreign commerce." (441 U.S. at 450-451). The Court cited the mutual participation of the United States and Japan in the Customs Convention on Containers as the source of desirability for uniform treatment of containers; the Convention stated that containers temporarily imported are free from "all duties and taxes whatsoever", a national policy of federal uniformity that the subject tax will frustrate. The Court brought into the case an element of "reciprocity" by indicating that since American-owned containers are not taxed in Japan, the tax creates an *asymmetry* to Japan's disadvantage, thereby creating an acute risk

of Japanese retaliation (441 U.S. at 452-453). A form of nascent immediate and direct retaliation was recognized by the Court, the European Economic Community's determination to consider "suitable counter-measures" when informed of California's tax.

Several further observations on the *Japan Line* decision are in order. On first reading, it appears to hold rather unequivocally that the four requirements for interstate tax validity are met. On more careful reading however it is seen that the *Japan Line* Court only assumes, without deciding, that the requirements are satisfied so that it may proceed to the foreign affairs discussion (441 U.S. at 445, 451). This is important to us only with reference to the claim by the Plaintiffs that the four interstate standards have not fully been met (POB Page 154-162) and the FTB's counter argument that they have been met as a matter of law (DB Page 17-21). *Japan Line* does not foreclose Plaintiffs from pursuing their position in this regard.

Japan Line deals with a tax on an "instrumentality of commerce", foreign commerce. It does not tell us whether a foreign parent of a domestic corporation or a foreign corporation doing business in California is an instrumentality of commerce that must be determined from other authorities.

Japan Line involved a tax on tangible personal property not income, a more abstract form of property. Seizing on this difference, one can argue that all the *Japan Line* pronouncements are dicta as they apply to this case. In the judicial sphere what is dictum and what is legal pronouncement are more frequently than not determined by later judicial inclination. The *Japan Line* doctrines were however treated as law, not dicta, by the *Container court* (see infra). There is a distinction, for obviously there are differences between a cargo container and a corporate entity; and certain legal principles applicable to one need not apply to the other. But to the extent that the U.S. Supreme Court makes special pronouncements on a subject which readers find reasonably applicable to a variation of the subject or to a wholly different subject, those pronouncements are, to this judicial officer at least, controlling law; only the Supreme Court itself should declare them inapplicable as dictum or otherwise.

The case is very strong in its expressions regarding sensitivity of foreign affairs to any intrusions by individual states. Although finding the existence of an actual double taxation, it clearly applies its rule of law to potential double taxation depending upon appropriate "considerations", which it does not define except that they must constitute a substantial burden on foreign commerce (although any burden thereon is suspect). It is almost insistent in its demand that in foreign matters, at least with specific aspects thereof, the federal government alone be involved (one voice). As to its judicial effect upon a unitary tax case such as FTB's, assuming the context of a foreign corporation doing domestic business either directly or through a subsidiary, *Japan Line* is strongly supportive of Plaintiff's foreign commerce claim. It recognizes the "custom of nations" as a significant foreign affairs concept. It reaffirmed the Dormant Commerce Clause principle. It viewed as significant in the foreign affairs context the role of reciprocity (a tax by foreign nations on American companies or property balanced by a comparable American tax on foreign companies or property) and the correlative concept of asymmetry.

B. *CONTAINER*

This decision is so very close to the present case that its every aspect must be examined carefully for its effect hereon. It involved the same State (California), the same agency (Franchise Tax Board), and the same tax (income). The sole juridical difference is that it involved a domestic parent corporation (Delaware — headquartered in Illinois), with foreign subsidiaries doing business and being taxed in California; while here we have a foreign (United Kingdom [UK]) parent corporation whose foreign (UK) subsidiary, directly and through its California subsidiary (Barclays Bank of California [BARCAL]) did business in California and was naturally subject, as was BARCAL, to California income taxation. The specific issue of constitutionality of the application of California's unitary taxation method, known also as World Wide Combined Reporting (WWCR) to a Barclay type business group was reserved expressly by *Container* (463 U.S. at 189, FN 26 and 195, FN 32). Three questions were presented literally to the *Container* Court for its review: (1) Whether the business group was properly a

"unitary business" for purposes of the tax, (2) If so, did the WWCR method as applied to the Container network of corporations violate the constitutional requirement of "fair apportionment"? And (3) Did California have an obligation under the Foreign Commerce Clause to employ the "arms-length" method used by the Federal Government? (463 U.S. at 165). Though the Supreme Court thus phrased the third question, it is but another way of asking whether WWCR was constitutionally appropriate. *Container* held that the group there involved was properly "unitary", that the apportionment was fair, and that the use of WWCR did not violate the Foreign Commerce Clause.

Here there is no issue of whether the Barclay group is properly a unitary group, that question having been conceded by the Plaintiffs for purposes of this case.[2] *Container's* discussion thus affects us as to its second and third questions. It is notable however that *Container* reaffirmed the general rule that under both the Due Process and Commerce clauses a state may not "tax value earned outside its borders" when imposing an "income-based" tax. But because businesses operating across state lines make precise territorial allocations of value impossible, States have been permitted constitutionally to use "formulae" for apportionment, with the taxpayer having the distinct burden of showing by "clear and cogent" evidence that a challenged tax falls on extraterritorial values (463 U.S. at 164).

On the question of fair apportionment, *Container* emphasized the taxpayer's burden to prove that the income apportioned to itself by the taxing entity and its methodology is "out of all appropriate portion to the business transacted" within that entity (463 U.S. at 180-181). In this regard the Court noted the argument that the foreign subsidiaries are significantly more profitable (that argument also is made here by Plaintiffs — POB Page 149-154), and California's three factor formula systematically distorts the true allocation. Citing *Mobile Oil Corp. v.*

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[2]There is a secondary issue however as to whether within the rubric of determination of the unitary group and application of an apportionment formula to it, the formula is "fair" (463 U.S. at 169 — POB Page 154 et seq.). It will be addressed in due course.

Commissioner of Taxes (1980) 447 U.S. 207, the Court rejected this argument in the face of considerable evidence supporting such distortion; such evidence "does not by itself come close to impeaching the basic rationale of the three factor formula" (463 U.S. at 182). As an example of a distortive effect "outrageous" enough to sustain the taxpayer's burden, the Supreme Court presented a formulary attribution of 66% to 85%, struck down in *Hans Rees' Sons, Inc. v. North Carolina Ex. Rel. Maxwell* (1931) 283 U.S. 123, compared to below 21.7% under a separate accounting analysis in *Container* (463 U.S. at 180-181). Observing that the percentage increase in *Container's* facts from the taxable income as filed to the taxable income as revised by WWCR was but 14% compared to over 250% in *Hans Rees'*, the Court concluded on this issue that the 14% figure was "certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business" (463 U.S. at 184). The evidence in this case (Barclay) indicates that the final tax figures for 1977 after the protest procedure resulted in a combined tax increase for both Barclays Bank International Ltd. (BBI) and BARCAL from an aggregate of $555,724.03 to $859,822.03, a difference of 28%; the taxable income figures are comparable. Given the strong language of *Container* on the issue of fair apportionment and the very heavy burden placed upon the taxpayer on this issue, coupled with the fact that the *Container* Court had before it and considered substantially the same evidence as was presented here (except perhaps the evidence on costs of compliance), I conclude that the use of WWCR here did not apportion income to BBI and BARCAL in an amount "out of all appropriate proportion to the business transacted" in this State. I make the same ruling with regard to Plaintiffs' claim of unfairness of the formula per se as applied to foreign multi-state corporations. While *Container* has its two "fairness" concepts, one respecting the formula (463 U.S. at 169) and the other respecting the apportionment (463 U.S. at 180), I discern no appreciable difference between the two. The opinion discusses both in the context of the "all appropriate proportion" burden. Moreover I do not conclude that cost of compliance is a factor entering into the fair apportionment and fair formula rules, which in my opinion focus upon the tax itself and its treatment of

multiple entity income, not with the taxpayer's burden or cost. To the extent therefore that Plaintiffs claim unconstitutionality of the use of WWCR on grounds of fairness or fair apportionment, my decision is in favor of FTB.

The *Container* case proceeded to the "additional scrutiny required by the foreign Commerce Clause . . . . The case most relevant . . . is *Japan Line.*" (463 U.S. at 185). This disposes undeniably of any potential claim that *Japan Line* is distinguishable and not controlling as to its enunciation of certain principles of law because it involved a property and not an income tax. The Supreme Court certainly did not so consider it, although it was mindful of its factual basis.

The Court found four important similarities to *Japan Line,* (1) There was actual double taxation by California and foreign nations in both cases (which FTB does not here seriously dispute), (2) The double tax stems from seriously divergent taxing schemes of the taxing authorities, (3) The foreign taxing scheme is consistent with "accepted international practice", and (4) The Federal Government "seems to prefer" the international (arm's length) taxing method (463 US at 187). The Court also found three clear distinctions from *Japan Line,* (1) *Japan Line* involved a property tax, (2) the double tax in *Container* is not the inevitable result of California's tax scheme, and (3) the tax does not fall on the "foreign owners of an instrumentality of foreign commerce, but on a corporation domiciled and headquartered in the United States." (463 US at 188) Referring to its reservation of the *Japan Line* holding's application to "domestically owned instrumentalities engaged in foreign commerce," it then stated ". . . to the extent that corporations can be analogized to cargo containers in the first place — this case falls clearly within that reservation" (463 US at 188-189).[3]

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[3]This disposes to my satisfaction of the question of a corporation being or not being an "instrumentality of commerce." Despite disagreement on this question (DB p. 45-46), the quoted statement from Container makes it clear, along with the rest of the opinion, that a corporation for legal and constitutional purposes is treated as an instrumentality of commerce, whether actually it is or not.

The court went on to expatiate on the similarities and dissimilarities to *Japan Line*. It reaffirmed the literal *Japan Line* expression that "even a slight overlapping of tax — a problem that might be deemed *de minimis* in a domestic context — assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." Taking into account the context of the *Container* tax, which the rule itself requires, and the fact that even the adoption of an arm's length method would not guarantee an end to double taxation, the Court found the rule not determinative (463 US at 189-193), pointing out here again the distinction between a property tax and an income tax (463 US at 192).

Proceeding to *Japan Line's* impairment of uniformity and speaking with one voice concepts, the Court uttered the phrase: "In conducting this inquiry . . ., we must keep in mind that if a state tax merely has *foreign resonances*, but does not *implicate* foreign affairs, we cannot infer, 'absent some explicit directive from Congress . . . that treatment of foreign income at the Federal level *mandates identical treatment* by the States.'" (Emphasis added) (463 US at 194). The Court continues: ". . . a state tax at variance with Federal policy will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear Federal directive [a species of pre-emption]." (463 US at 194) Here the Court went on to explain its problem, that as a Court (presumably in the absence of specific evidence) it has little competence in determining when a foreign government is or will be offended and in how to balance a risk of retaliation against the sovereign right of the United States to let States tax as they please. "The best we can do . . . is to attempt to develop objective standards . . . about the imperatives of international trade and . . . relations." (463 US at 194). For three reasons, the Court concluded against the possibility of justifiable foreign retaliation, first there was no automatic asymmetry in *Container* second the tax was imposed not on a foreign entity but on a domestic corporation ("The legal incidence of the tax falls on the domestic corporation"), and third the California tax rate could be raised, thereby having the same financial foreign effect; and whether so or no, the offense to the foreign entity would be attenuated (463 US at 194-195). With reference to the

second reason, the Court inserted a footnote pointing out that this tax effect on a domestic corporation "might be less significant if the domestic corporation was owned by foreign interests".

The Court then noted the absence of a United States Amicus Curiae Brief, which though not dispositive was suggestive that United States foreign policy ("whose nuances . . . are much more the province of the Executive Branch and Congress than of this Court") was not seriously threatened by California's WWCR (463 US at 196). This clarifies the role of the United States as an Amicus — its presence in that capacity is not merely as a traditional "friend of the Court" with the Attorney General as its lawyer, but is a substantive exposition of the Executive's view of foreign affairs implications in this unique type of case. Were it otherwise as a matter of the Supreme Court's law, the *Container* court would not have mentioned it in so positive a way. This judicial statement also is an indication of the significant role of the Executive in foreign affairs, confirming that despite the literal language of Article I, Section 8, Cl. 3, giving *Congress* control over foreign affairs, that control is shared between the Congress and the Executive (with Congress supreme as between the two). There is no truly serious disagreement on this between the parties, although they expectably disagree as to its application in this case.

After thus concluding that foreign affairs were not implicated by California's unitary tax in a domestic corporation context, the *Container* Court went on to the final consideration that a "clear Federal directive", if present and proscriptive of WWCR, would have voided the latter's use by the FTB. It found none. There was no Federal statute, despite long debates in Congress. The numerous Tax Treaties of the United States require it to adopt some form of arm's length analysis in taxing the domestic income of multinational enterprises, but "that requirement is generally waived with respect to the taxes imposed upon each of the contracting parties on its own domestic corporations. This fact, if nothing else, confirms our view that such taxation is in reality of local rather than international concern." (463 US at 196). The tax treaties do not apply the arm's length requirement to the States. Finally, the Senate "reserved" a clause making the re-

quirement applicable to the States in the process of ratifying the 1977 US-UK Treaty.

By way of general commentary on the case, it appears that *Container* receded somewhat from the stronger one voice position of *Japan Line*. Where *Japan Line* was almost eager to anticipate retaliation, *Container* professed practical impotence on the subject. The very large emphasis of the case in distinguishing *Japan Line* was in two areas, the income vs. property tax distinction and the domestic vs. foreign corporate tax effect. The foreign commerce power was recognized as exercisable and exercised by both the Executive and Legislative branches. The Tax Treaties and their content were considered. The Senate's reservation of Clause 9(4) from the US-UK Tax Treaty of 1977 was mentioned to suggest an absence of intention by Congress to occupy the State tax field.

C. *WARDAIR*

Florida imposed a sales tax on aviation fuel purchased within its boundaries by Wardair, a Canadian corporation which operates charter flights between Canada and the United States. Wardair claimed the tax was precluded by the Foreign Commerce Clause and a clear directive of Congress implicit in the Federal Aviation Act (FAA). The Supreme Court held, "We disagree . . . and find that Congress has not acted to preempt state taxes such as that imposed by Florida. Accordingly we affirm. . . ." (106 S.Ct. at 2370).

Congress has not occupied the field by enacting the FAA, states the Court. Where a Federal statute does not expressly preempt a state law and there is no actual conflict between the two laws, "we have required that there be evidence of a Congressional intent to pre-empt the specific field covered by the state law" (106 S.Ct. at 2372). Instead of precluding this tax, the FAA expressly permits it, but in general terms ("taxes on the sale of goods and services"). But it may be that Congress didn't consider in the FAA that *foreign* carriers could be taxed, so the Court did not rely on that enactment to answer the Commerce Clause issue; but it answered Wardair's pre-emption argument (Ibid).

The Court then turned to Dormant Commerce Clause considerations, explaining that this doctrine is grounded on the absolute need for uniformity even where Congress has not acted (106 S.Ct. at 2373). It reviewed the four basic tests involved in interstate (and foreign) commerce matters and the additional two that must be considered where foreign commerce is involved. The first four tests were not involved in the case; nor the first of the next two, because no double tax existed in a "discrete" sales tax context. Only the last, the one voice test, was involved, with Wardair and the United States (as Amicus, through the Solicitor General) urging the existence of a Federal policy in the taxation of instrumentalities of international air traffic. The Supreme Court disagreed, holding that the evidence showed no such Federal policy but on the contrary a policy *permitting* such taxation, so that no Dormant Commerce Clause discussion at all was needed (106 S.Ct. at 2373-2374).

From a study of the Chicago Convention on International Civil Aviation of 1944, a 1966 "Resolution" of the International Civil Aviation Organization, and more than 70 bilateral agreements (to all of which the United States was a party), the Court concluded that while there is an international *aspiration* to eliminate a fuel tax, the law currently *acquiesces* in such tax by political subdivisions of countries. The Chicago Convention demonstrates international awareness of the problem of state and local taxation of aviation fuel and a decision to limit it in some respects but not this one. The Resolution, while clearly opposing such a tax, has not been "signed, entered into, agreed upon, approved or passed by either the Executive or Legislative branch of the Federal Government"; it is merely the work product of an organization of which the United States is a member. It is not a policy of the United States (106 S.Ct. at 2374-2375).

The *Wardair* Court notes that since the Chicago Convention, the United States became a party to each of the over 70 bilateral agreements, all of which forbid federal taxes on aviation fuel but none of which, including the one with Canada eight years after the Resolution, interdict it at the local level. "By negative implication arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least

acquiesced in state taxation of fuel used by foreign carriers in international travel." This is an affirmative decision to permit this tax (106 S.Ct. at 2375).

Wardair adds to our understanding of the Supreme Court's teachings in the area of state taxation of foreign commerce the following. Federal policy in a given area of foreign affairs may be found by negative implication from a series of international agreements entered into by the United States (presumably negotiated and executed by the Executive and ratified by the Senate) with knowledge of a specific problem or concern, in which the latter is ignored, while focusing on another, but related, problem. Federal policy will not be found by mere membership in an international organization which itself expresses a policy on a subject of international concern.

IV

RESOLUTION OF ISSUES

Plaintiffs divide their post-trial briefing arguments into four headings, (1) WWCR infringes upon the exclusive power of the Federal Government to deal with foreign affairs; (2) WWCR violates the Supremacy Clause (pre-emption); (3) WWCR impermissibly burdens commerce; (4) WWCR discriminates against foreign commerce and is internally inconsistent, in violation of the Commerce and Due Process clauses; and (5) as applied to foreign based unitary groups, WWCR deprives them of property without due process. FTB argues (1) Plaintiffs have not sustained the burden of proving both illegality of FTB's tax *and* the correct amount if Plaintiffs are correct; (2) Plaintiffs are barred as to the foreign affairs issue by failure to exhaust administrative remedies; (3) Congressional foreign policy prevails over that of the Executive; (4) *Container* and *Wardair* compel judgment in FTB's favor; (5) even under a Dormant Foreign Commerce clause analysis, WWCR is not a violation; (6) Plaintiff's burden on cost of compliance with WWCR as a Constitutional violation has not been met; (7) FTB's procedures on WWCR do not violate due process; and (8) this court has no jurisdiction to impose a "Water's Edge" rule on FTB. A ruling adverse to FTB's

second point has heretofore been made; the others remain. Considerable overlap is noted between and among a number of the contentions of both parties. It is inevitable, for as heretofore observed specifically with a segment of the *Container* case, the various operative doctrines themselves overlap. Necessarily also this court's resolution of the tendered issues will overlap.

A. *WWCR AS AN INFRINGEMENT ON THE FOREIGN AFFAIRS POWER*

As a general rule, there is no doubt (nor any disagreement between the parties) that in the area of Foreign Commerce, the power of the Federal Government is exclusive. Any infringement upon that power by state legislation is prohibited constitutionally (*Zschernig v. Miller* (1968) 389 U.S. 429; *Bethlehem Steel Corp. v. Bd. of Comm'rs* (1969) 276 CA 221).

Plaintiffs proceed to assert that the WWCR tax method of California *implicates* foreign commerce. There is no doubt that it does, but does it do so in the *Container* sense (463 U.S. at 194), i.e., implicate rather than resonate? From the evidence presented to this court, I conclude that WWCR, as applied to foreign multinationals, implicates foreign commerce within the meaning of *Container*.

Historically, although there has existed for many years the unitary method of taxation by California, it never was seriously a factor in foreign affairs until "the early 1970's"[4] when California first applied it to foreign multi-national corporations. Thus, we cannot measure American or foreign governmental reaction to its international use by events prior to 1972, including the negotiations and ratifications of foreign Tax Treaties. Moreover, we cannot realistically determine such reaction until the FTB's expanded application had time to be felt by taxpayers, through FTB audits and assessments, protests, negotiations between foreign nations and the United States, etc. Thus, the multitude of Tax Treaties entered into and ratified prior to 1978, which tacitly permit state taxation of foreign businesses (subject, of course, to

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[4]To achieve some degree of precision I find the specific year to be 1972.

the four *Complete Auto* test for interstate commerce) are of no value to us here, as they were in *Wardair*. A given topic cannot have a realistic impact on foreign affairs until it arrives on the scene.

The interplay of the executive and legislative role in Foreign Affairs must here be given attention. They both act in the Foreign Commerce and Foreign Affairs area, with Congress in ultimate charge, either by treaty ratification or by direct legislation (see *United States v. Curtiss-Wright Export Corp.* (1936) 299 U.S. 304); *United States v. Pink* (1942) 315 U.S. 429). A federal policy is formulated by either branch, and it will not be presumed that they are at variance, although from time to time, variance doubtless exists. No such variance can be found here from the Senate's failure to ratify the 1975 UK-US treaty in its entirety. In 1975, in direct response to California's extension of WWCR to foreign, including British, multi-nationals, Clause 9 (4) was inserted into the new UK-US Tax Treaty (signed on December 1, 1975) which for the first time in tax treaty history, would have proscribed the tax as levied here. The Treaty reached the Senate in 1978. In the Senate Foreign Relations Committee, Senator Frank Church (of Idaho, one of the State's then taxing by the unitary method) introduced a "reservation" to 9(4); it was defeated 10 to 5. On the Senate floor, the reservation again was defeated 44 to 34. The treaty as signed then received a vote of 49 to 32, five votes short of the ⅔ needed. Thereafter 9(4) was reserved without a vote and the treaty was ratified with the reservation. It was later approved by the British Parliament, but only after strong assurances by our Executive that the matter would be yet resolved (as indeed it partly was; inter alia, by California's 1976 legislation allowing a Water's Edge method effective 1/1/88) to eliminate WWCR with reference to UK multinationals. Am I to conclude from that a Congressional "foreign policy" *favoring* WWCR income taxation of foreign multinationals by individual states? No. Not in the face of three majority votes (one in committee and two on the floor) favoring

discontinuance of the practice.[5] If it shows anything at all, it is a Congressional preference, not rising to the dignity of a policy, favoring the elimination of WWCR in a foreign multinational context. Meantime the evidence shows unequivocally that the Executive branch all along, under three administrations since the WWCR problem in the present context became known, has steadfastly adhered to a policy of use of the arms length/separate accounting (AL/SA) method and not WWCR, both as to the States and the Federal Government.

FTB may argue somewhat logically that the negotiation, execution, and ratification of numerous tax treaties without 9(4) since 1978, with consequent knowledge of the Senate's action, shows a policy favoring whatever method, including WWCR, a state wishes to use. Indeed there is some prima facia support in *Wardair* for this position. But what was lacking in *Wardair* was (1) the consistent and continual Executive expression of policy and (2) the actual 1978 Senatorial episode, the only time Congress (or at least one-half of it) actually focused on WWCR in the international context. The Executive's foreign policy can only be what the Executive says it is, by official communication to foreign nations, by similar communication to the states and to Congress, by Amicus briefs, etc. (that is why none of this is hearsay). In one respect only has the Executive arguably varied from its policy, when it withdrew support for pending legislation in the Congress; but that is nothing more than a preference of methodology to achieve its policy, not a change of it. The Congressional foreign policy likewise can only be what Congress says it is. But what the Congress says, it says by affirmative legislation, or secondly by rejection of proposed legislation or to some extent by Senate action on Treaties; or possibly by implica-

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[5]This ruling is not inconsistent with *Container's* reference to the Senate vote in support of its rejection of the claim made there. I note no analysis of the Senate action by the Supreme Court; more important the *Container* Court used this as an example of *no* congressional policy, not as establishing affirmatively a policy for or against.

tion from Congressional enactments. But Congress cannot otherwise have an "intent", being the collegial body that it is.[6]

There is an international standard of accounting universally practiced by all nations of the world, including the United States, the AL/SA method. It is used to determine income of business entities derived from operations in countries other than their own, for purposes of income taxation by those countries. It operates on the assumption that only the income actually earned within a foreign country should be taxed by it (no double taxation), but because that cannot always be determined with exactitude, AL/SA uses formulary allocations when and as needed. But it is undisputed that its aim is to determine as closely as possible what actual income is derived from activities within the geographical boundaries of the taxing nation, and tax that income only. It has many flaws and imperfections, and some double taxation occurs under it, as so capably testified to by Professor Jon Bischel, but it is there as an ideal and as a working methodology. No other system is used internationally.[7] The numerous United States tax treaties however, all of which embody AL/SA, apply it to the income tax of the nations themselves and are silent with reference to taxation methods of their political subdivisions.[8]

WWCR on the other hand is a creature of California's FTB, and has been employed by other States of the United States as well, in assessing state income taxes on interstate and foreign businesses. It differs markedly from AL/SA in that at the very outset it brings into its calculation all income of the California business taxpayer, from wherever derived. Then it allocates to California its share of that income for income tax purposes by

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[6]There is not to be found here, or in any other case to my knowledge, an Amicus brief by the Congress. Such a brief is of course impossible.

[7]There is an indication in the record that WWCR is used optionally by France and Canada where appropriate to prevent double taxation (RT Page 1900 et seq.)

[8]The Advisory Commission on Intergovernmental Relations recommended both ways to the Congress, for and against legislation prohibiting WWCR (Exhibits 50B (1982) and 50 (1981)).

using a three part formula, property, payroll and revenue within this State, over total property, payroll and revenue respectively, the average of which yields the fraction for allocation purposes. This method has been upheld in the interstate context, and in *Container* in the international context where the taxpayer was a United States corporate entity with foreign operations through foreign subsidiaries (whose income was included under WWCR). In this case we have a foreign (U.K.) parent (Barclays Bank, Ltd. (BBL)) of its two taxable subsidiaries, BBI and BARCAL, contributing its own income and that of its over 200 foreign subsidiaries into the formula for income taxation of BARCAL and BBI. Does this taxing scheme as so applied implicate foreign affairs? Because the tax impact falls on BBL, the foreign parent, rather than on a domestic parent as in *Container*, I conclude it does.

The evidence establishes that the AL/SA concept is universally used and favored while WWCR is everywhere disliked except as to some States of the United States. It is this foreign view of WWCR as here applied[9] that causes it to implicate foreign commerce. It is of no moment that such a view might be erroneous or even that WWCR might be a better and more efficient method academically; what matters is the international perception of WWCR as an arbitrary, unfair, and predatory measure of income taxation. The evidence shows that it is so perceived. The very fact that at the outset of WWCR's application California reaches out beyond American territorial borders to include income of Foreign Corporations wholly uninvolved with California, generates a spontaneous conclusion that foreign commerce is being taxed. The first and very prompt adverse reaction to it was vigorous and immediately successful, the insertion of 9(4) into the 1975 UK-US treaty, negotiated and executed by the Executive. The next reactions were after the reservation of 9(4) in the Senate ratification. A 1979 trip to Washington by Michael John Grylls, Member of Parliament, was made to request relief from federal officials. By 1980, the Demarches from the European

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[9]Henceforth, unless otherwise noted, the abbreviation "WWCR" shall mean the method as applied in this case, i.e., a foreign parent case.

Economic Community started to arrive. They, along with other forms of diplomatic communication, showered the Executive with protests over California's WWCR and its departure from the international standard. The British Prime Minister spoke directly to the President about it. The President on October 26, 1983 established the "Working Group" to work on and suggest means of solution of this international problem — the Group reported in 1984, recommending inter-alia an end to WWCR. The UK in its Finance Act of 1985, enacted but did not implement a form of retaliation which had some effect on dividend policies of American companies operating in Britain. Finally, California went to a Water's Edge solution (Exhibit 55), thereby alleviating much of the international outcry. Disruption and embarrassment to the federal government necessarily resulted.

B. *THE SUPREMACY CLAUSE (PRE-EMPTION)*

There is no pre-emption here, not in the sense in which Plaintiffs assert it. The *Hines v. Davidowitz* (1941) 312 U.S. 52, 62 type of pre-emption specifically referred to by Plaintiffs (POB Page 42-43) exists in circumstances in which the nature of the State action affecting foreign affairs is so much in obvious conflict with the Constitution's insistence on federal involvement only, that the Constitution in and of itself has "pre-empted" the action. After so stating the rule, Plaintiffs go on to argue its existence by referring to the federal position on AL/SA and to claimed Congressional pre-emptive action (POB Page 43-50).

As heretofore indicated, I find no Congressional expression either way on this subject. Moreover that issue is disposed of by the *Container* case, for it found no Congressional expression of policy inconsistent with WWCR; nor did it find any such policy consistent with it. As to what might be termed "inherent pre-emption" of the *Davidowitz* or *Bethelem Steel* style, I find it present *in the specific context of this case*, a foreign multinational parent whose local subsidiary is taxed by WWCR. Discussion on this point will however be deferred to the next heading where it more appropriately belongs. It is my firm belief that the second of the two additional *Japan Line* tests for commerce (need for federal uniformity) is the equivalent of inherent pre-emption. The

latter also includes the so-called "Dormant Commerce Clause" analysis.

C. *WWCR'S BURDEN ON FOREIGN COMMERCE*

The second of the two additional *Japan Line* tests forbids a state tax on instrumentalities of foreign commerce, which as above stated includes by analogy, and applies to, corporations. I conclude from the evidence before me that in this case, in which the burden of the state tax falls ultimately upon a foreign parent of the taxed subsidiary, federal uniformity is essential. If California may permissibly impose this burden, so may every other state where business is conducted; and with variations, such that international chaos in the form of confusion, dissension, offensiveness, embarrassment, and retaliation are likely to result.

This case factually demonstrates as extreme an example of predictable international consequences stemming from a local tax as can be conceived. BBL, the UK corporate parent, in 1977 owned over 220 subsidiaries (including subsidiaries of subsidiaries) throughout the world, of which two only were incorporated in the United States (Barclays Bank of New York [BBNY] and BARCAL). One other only, BBI, a UK company, also did business in the United States. BARCAL was a subsidiary of BBI, along with BBNY and over 70 others operating in some 34 nations and territories outside the UK. BBL operated in some 60 nations, including those in which BBI and its subsidiaries operated. The percentage of total unitary income of the Barclays corporate network attributed by the FTB to California (both BARCAL and BBI) for 1977 was less than one and one-half (1.5%). Yet the 98.5% of the Barclay's Group income having its source outside the United States (except for the insignificant, relatively speaking, income of BBNY — See Exhibit 52R) was included in the pot from which California's 1977 income tax was to be measured, and thereby raised the tax by $154,098.00. We may say what we will about how it tends to average out over the years, how it is a relatively inconsequential sum in the overall Barclay's financial scheme, how it is no worse in actuality than AL/SA, and the like; but we cannot avoid a justifiable reaction by BBL, steeped as it is in the AL/SA tradition, of outrage. The

ensuing similar reaction of the UK, one of America's closest trading partners, is not only understandable but highly empathetic. Diplomatic consequences in the form of protests, negotiations, treaties, Executive and Congressional activities, retaliatory legislation, etc. followed, all but the last joined in by a multitude of other foreign trading partners. The record is full of examples of how the income taxation method of one state (California) has caused an inordinate amount of international furor. This is an area in which the federal government should be speaking with one voice; its foreign affairs are "implicated" by California's WWCR.

Let me stress that while we have empirical evidence of adverse international reaction, none was needed for the one voice principle to apply. Given the background up to 1977 of AL/SA and the custom of nations, given the nature of WWCR, given the addition to *Container's* factual setting of the fact that the tax burden falls on a foreign multiple parent corporation, the impact on foreign affairs was inevitable. And it was sufficiently unique and substantial to require uniformity of action in dealing with it.

FTB argues that the foreign brou-ha-ha was contrived, orchestrated by the UK alone so as to bring before this court the very evidence presented at the trial, including a disingenuous piece of "retaliatory" legislation that does not retaliate. We are of course aware that British lawyers can read and interpret *Japan Line*, *Container*, and any other Supreme Court case as well as we; and action can be taken accordingly. So without accepting the metaphors, I can accept the obvious fact that Britain took the lead in initiating the outcry and causing others to join in it (the EEC for example). But how else is foreign reaction generated? Someone must begin the outcry, and inevitably and understandably will cause others to join in it. The foreign reaction was and is no less genuine because Britain brought it about. As to the British legislation, it is indeed retaliatory if effectuated by "laying an order" in the British parliament, which has not yet been done. But such retaliation was not at all beyond possibility and likelihood up to 1986, when California went to Water's Edge. In that regard I am mindful of our own government's recent imposition of tariffs on certain Japanese imports, after endless frustrating efforts to obtain from Japan voluntary alleviation of what we perceived as

unfair Japanese trade practices. That action was very real, and against one of our closest trading partners, much like Britain. There was no frivolity associated with Clause 27 of the 1985 Finance Act.

In dealing with the federal uniformity test, *Container* posited the judicial lack of competence "to determine precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please. The best we can do . . . is to attempt to develop objective standards that reflect very general observations about the imperatives of international trade and international relations." (463 U.S. at 194). One difference here is that we do have considerable evidence, which the *Container* Court did not have, of actually offended foreign nations and why WWCR offends them, enough to compel a finding of such offense. But in addition I have developed an objective standard about the imperatives of international trade and relations. That standard is that where a foreign multinational's non-domestic income is included in a formula for attribution of income taxable by a State of the United States in which that entity does business through a branch or subsidiary, given the custom of nations as to AL/SA, foreign nations will be offended, our federal government will be assailed by foreign protests, the possibility of justifiable retaliation is very real, and a need for federal uniformity exists.

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The first of the two additional requirements to sustain a tax on foreign instrumentalities of commerce is "the enhanced risk of double taxation". The emphasis of this test is not on foreign reaction so much as on the more elusive and academic question of double or multiple tax.

There is a definite risk of, as well as actual double taxation here, but it is not inevitable as required by *Container*. While it plays a role in my ruling regarding federal uniformity, the *Container* holding prevents its application to the first test. All the same aspects of double taxation involved here were involved in

Container, although I agree with Plaintiffs that in this foreign multi-national context they are more aggravated. But all of them were essentially considered and rejected in *Container* (463 U.S. at 189-193). The only one that gives me pause is the automatic "asymmetry" which I find exists here but did not exist in *Container* (a domestic corporation using foreign subsidiaries to do business in foreign countries is not subject to WWCR); but I note that *Container* discusses it under the rubric of the second test, federal uniformity in foreign affairs (463 U.S. at 194-195), as does *Japan Line*, (441 U.S. at 452-453). Under that test, automatic asymmetry is one of the by-products of WWCR upon which I relied in finding WWCR unconstitutional as here applied.[10] But the automatic asymmetry factor is not a consideration in the multiple taxation test. I am bound to follow Supreme Court precedent. To keep faith with *Container's* precedent I conclude that WWCR passes the first test.

D. *WWCR'S ALLEGED DISCRIMINATION AGAINST FOREIGN COMMERCE*

There is defacto discrimination against Foreign Commerce in the context of this case. I find credible the evidence which shows that a foreign based multi-national does not have readily available to it the necessary financial accountings from many of its foreign subsidiaries to enable it to comply with WWCR's requirements and concurrently take advantage of certain benefits available under California tax law. Tax accounting and financial accounting are admittedly different; one does not and should not normally use the accounting appropriate to an annual shareholder's report to prepare and file an income tax return, in California or elsewhere. There are United States GAAP (Generally Accepted Accounting Principles), United Kingdom GAAP, and other systems, varying to greater or lesser degrees from nation to nation. There are developed nations and developing nations, with different needs

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[10]It is not feasible for me in this Intended Decision to refer to every specific item of evidence which supports a finding or conclusion. Many Exhibits and much testimony not specifically enumerated support the various parts of this determination.

and different accounting methods and procedures. Books of foreign subsidiaries of BBL (and BBI) are kept in accordance with accounting procedures in the country of incorporation or in which they do business. The Internal Revenue Laws and Regulations of the federal government contain specific rules affecting income taxation of foreign multi-nationals, but they include only income whose source is within the territorial borders of the fifty states, and such income is determined under AL/SA; thus the income of foreign subsidiaries is ignored. Foreign parent corporations which do business in California must under WWCR report to FTB the income of their subsidiaries. But that income as reported to the parent sans WWCR is reported and accepted as prepared by and for each subsidiary. Nothing further by way of adjustment or information is needed nor is appropriate for the parent from those foreign subsidiaries to enable the parent to file tax returns in its own country and with the IRS. But when it becomes necessary for the foreign parent to report its foreign subsidiary's income to the taxable entity for inclusion in WWCR, the readily available financial information does not fit. There are adjustments that must be made (e.g., translation of currency, adjustment of fixed assets, leased assets and bad debts, conversion to GAAP, etc.) and others that can and properly should be made to take advantage of FTB's authorized deductions and other benefits[11] (e.g. depreciation allowances). Such information is not maintained on a current basis by those foreign subsidiaries and hence is not readily available and sometimes is totally unavailable. FTB's experts agree that literal compliance with WWCR is impossible, because no foreign multi-national maintains appropriate accounting books for it. The sole reason for changing accounting methodology to make it regularly available is to file properly under WWCR. The cost to reconstruct such information for past years is prohibitive; the cost to set up and maintain a system to obtain it currently by changing the accounting methodology in each appropriate foreign subsidiary is huge, over $5,000,000.00 to establish

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[11]There is no point in turning this into an accounting nightmare by further enumeration of the accounting changes and potential changes involved. But they are there.

and over $2,000,000.00 annually to maintain. Such amounts are conceded by FTB to be unreasonable if true; but they are claimed unnecessary for proper compliance. I find them so necessary.

Plaintiffs claim that this amounts to discrimination against foreign commerce because only a foreign multi-national is put in this position of either foregoing available tax reporting benefits (including the use of approximations — see infra) or spending inordinate sums to be in a position to file properly; or of course to discontinue business in California. Correlatively, competitive businesses not conducting business in other nations, including domestic parent corporations with foreign subsidiaries,[12] do not have this added burden, and hence are given an advantage by FTB. This is assertedly "economic protectionism". The claim is valid; there is a less intrusive and less burdensome alternative, Water's Edge; WWCR does unfairly and systematically discriminate against foreign multi-nationals and thereby unduly burdens foreign commerce. (*Boston Stock Exch. v. State Tax Comm'n* (1977) 429 U.S. 318; *Hunt v. Wash. State Apple Advertising Comm'n* (1977) 432 U.S. 333; *H. P. Hood & Sons v. Dumond* (1949) 336 U.S. 525.)

FTB counters this claim first by maintaining that dollar cost of compliance as presented by two Plaintiff witnesses is not credible; I have more than allowed for possible exaggeration, even though FTB presented essentially no evidence on the point. FTB's second defense is grounded on Cal. Adm. Code, Title 18, Section 25137-6, pursuant to which it claims there are alternatives to strict compliance with WWCR requirements. The regulation does specify that no adjustment to income is required unless it is material. It also allows use of reasonable approximations, considering the expense and effort required to obtain the necessary information for compliance. It also allows for advance determina-

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[12]Though domestic parents of foreign subsidiaries (See *Container*) have this same dilemma as to their foreign operations, they do not have it as a result of WWCR. They have it because federal income tax laws require it. Those same laws do not require it as to foreign subsidiaries of foreign parents.

tions of what the taxpayer proposes to do. All these are illusory to the taxpayer, for neither binds the FTB to accept anything; it has the complete authority to make the ultimate decision as to whether an item is material, as to whether or not an approximation is reasonable and will be accepted, and whether an advance determination will be made and in what way. There is no genuine alleviation of the taxpayer's problem by these techniques. There are certain situations in any type of taxing case and with any taxing authority, in which approximations must be resorted to. But taxation by approximation to avoid an unduly onerous dollar cost of compliance burden is not a cure.

E. WWCR AS VIOLATIVE OF DUE PROCESS

Plaintiffs claim that because an element of the WWCR calls for materiality, reasonable approximations, and advance determinations, all at the unfettered discretion of FTB, with no guidelines, there is a violation of the due process clauses (both U.S. and California) insofar as the tax relates to a foreign multinational.

The WWCR regulation is not on its face uncertain, nor does the approximation segment make it uncertain. Its taxing rules are sufficiently clear and understandable to satisfy due process. The discretionary advance determination, reasonable approximation, and materiality rules (materiality does not really belong in this thought —it is inherent and essential in every tax scheme) are only there to the extent a taxpayer seeks to avail himself of them. They are not imposed willy-nilly.

What does constitute a due process violation is the fact that all witnesses agreed that with customarily and currently available accounting data, literal compliance with WWCR requirements is impossible for foreign multi-nationals such as Plaintiffs, and the only way to "comply" is by supplication and negotiation (absent an unduly burdensome cost of compliance). There is no reasonable certainty and no judicial reason to believe that whatever the taxpayer considers reasonable or material will be so treated by the FTB. I certainly would not expect this type of pre-established capitulation from the fine and dedicated public servants (Ben Miller, Eric Coffill, Stephen Wetzel, etc.) whose efforts in the

State's behalf came to my attention at the trial. Bureaucratic mistakes and excesses are always possible.[13]

Thus I conclude that WWCR as applied to Plaintiffs violates due process, both federal and state. (*C.F. Chy Lung v. Freeman* (1876) 92 U.S. 275; *Grayned v. Rockford* (1972) 408 U.S. 104; *McDonnell Douglas Corp. v. Franchise Tax Bd.* (1968) 69 C2 506).

F. PLAINTIFFS' BURDEN OF PROOF

FTB claims that Plaintiffs have a burden to establish not only that the amount of tax assessed was improper but what the proper amount should be, citing *People v. Schwartz* (1947) 31 Cal. 2d. 59. I have no quarrel with the rule, but it does not apply here. Since the WWCR method has been found invalid, the additional assessment imposed because of it was improper; correlatively the amount originally paid is the correct amount, any excess over that having resulted from the invalid method. As to the dollar amount to be refunded by FTB, including interest, the parties have stipulated to calculate and insert that amount in the judgment (Exhibit 1, Page 2).

G. CONGRESSIONAL ACTION PREVAILS OVER INCONSISTENT EXECUTIVE ACTION IN FOREIGN RELATIONS[14]

This issue has been resolved favorably to FTB (See Section IV A, supra).

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[13]As where the FTB auditor here failed for arbitrary reasons to deduct from plaintiffs' total income (working off an annual report for lack of better information) that attributable to "associate" (less than 50% owned) companies of BBL.

[14]FTB's jurisdictional argument (DB Page 6-7) has been disposed of under Section II.

H. EFFECT OF CONTAINER AND WARDAIR

FTB has relied heavily on its interpretation of these two cases. If indeed they were to be so interpreted, the judicial result would have been in FTB's favor. In the course of resolution of Plaintiffs issues as tendered I have resolved FTB's contentions partly in FTB's favor and partly otherwise.

Container did conclude that the "four usual issues" involved in state taxation of both interstate and foreign commerce resolved themselves in FTB's favor (DB Page 17-21). *Container* determined there was no expressed Congressional policy *against* WWCR, but did not address the question of whether such policy was expressed Congressionally *for* it. (DB Page 21-22). The issue was certainly there for *Container* to address, and had such policy been so found it would have ended the inquiry and avoided the need to address the two additional *Japan Line* factors. The failure to deal with that issue has led me to interpret *Container* as indicating judicially no Congressional policy either way.

Proceeding to the first additional *Japan Line* test, in its Dormant Foreign Commerce Clause analysis *Container* resolved it in favor of FTB. I respected that precedent and have followed it. *Container* did likewise regarding the second test, but it was necessarily limited to a domestic parent case, and I have found enough constitutionally significant differences in this foreign parent case to determine WWCR invalid as here applied. The great disagreement of FTB comes from its interpretation of the *Wardair* holding (DB Page 23-43) to the effect that Congressional "acquiescence" can and will establish a foreign policy. Citing five indications of such acquiescence both Executively and Congressionally (Income Tax Treaties, U.S. Model Convention and Reservations to OECD and UN Model Conventions, FCN Treaties, Senate Action Regarding 9(4), and no enactment of proposed legislation to prohibit WWCR), FTB maintains that *Wardair* compels a finding of policy by acquiescence here. Each factor was carefully considered, and I found no sufficient similarity to *Wardair* to suggest its application. *Wardair* involved an uninterrupted string of Treaties, Conventions, and legislation, before and after the tax year, with no specific disagreement or dispute either by Congress or the Executive (except for an amicus

brief). Here we have no manifestation of the problem until 1972, followed by a prompt expression of Executive policy opposing state WWCR in 1975 (the Treaty), echoed by the Senate in its actual vote count in 1978, followed by nothing of consequence thereafter from Congress and uninterrupted perseverance in its policy by the Executive. The U.S. Model Convention, like the tax treaties since 1978, does not impress me as indicative of a policy (See IV A, supra); "reservations" are just that, reservations of opinion and not themselves opinion or policy; a failure on the part of Congress to vote on a pending bill expresses nothing by way of intent and I have no evidence that Congress actively voted to defeat proposed legislation outlawing WWCR. With every respect for FTB's *Wardair* argument and the competent manner in which it was presented, I disagree.

Bass, Ratcliff & Gretton, etc. v. State Tax Comm. (1924) 266 U.S. 271, involving a unitary form of tax on foreign commerce is contended by FTB to have been confirmed by *Container* (DB Page 17, FN 10) and to be persuasive here. I cannot agree. If *Bass, Ratcliff* were considered authority for the broad proposition that WWCR is constitutionally proper as to foreign multi-nationals, *Container* would simply have cited it for that proposition and it would have ended the Court's inquiry. Instead, after citing it, the *Container* court twice expressly reserved this very question, thereby making it clear that *Bass, Ratcliff* is not precedent for FTB's contention here.

I. DORMANT FOREIGN POLICY ANALYSIS

This issue has been addressed. No double taxation proscription was found, following the precedent of *Container*, but the need for federal uniformity was found. FTB's arguments on double tax (DB Page 46-60) have been accepted or are academic. FTB's arguments on federal uniformity (DB Page 60-72) have been considered (IV A and IV C, supra), and found unpersuasive.

J. COSTS OF COMPLIANCE

FTB presents its position with reference to the legal and constitutional effect of Plaintiffs' evidence of their costs of compliance with California's WWCR regulation at DB Page 73-97.

All of it has been considered and dealt with in connection with IV D, supra. There are several points made by FTB however regarding which some comment is appropriate.

FTB claims of course that Plaintiffs' alleged costs of compliance are exaggerated and not genuinely necessary. An example is given of the fact that BBI actually did undertake to file for 1977 (and prior years) on a WWCR basis, and it has many foreign subsidiaries whose income was included in the return, prepared at a very nominal charge by Price Waterhouse (DB Page 77-79). I find this unpersuasive. The return was not prepared in accordance with Regulation 25137-6, and for this reason it was rejected by FTB (along with prior similar returns). It was erroneous in that it used figures from the annual report, admittedly inaccurate for income tax purposes. Furthermore, the fact that a taxpayer complies or attempts to comply with a tax scheme he considers invalid does not prevent him from presenting fully his reasons for its claimed invalidity in later protests. I am aware of no estoppel principle that applies here. And while I have understood the point of this FTB argument I find it without merit.

FTB suggests that Plaintiffs' costs of compliance evidence is not worthy of belief because no money has yet been spent by Plaintiffs to comply (DB Page 84). This begs the question. It would be folly for a taxpayer who claims a given tax is invalid to spend millions to comply with it when he is concurrently challenging it formally by lawsuit.

Finally in response to Plaintiffs' claim that WWCR offends American policy of encouraging foreign businesses to invest in this country, FTB points to continuing success and prosperity of Plaintiffs in California (DB Page 96). FTB misapprehends the policy. The fact that a certain business is successful does not negate the propriety of its efforts to defeat actions perceived to be harmful to the policy. The policy does not encourage foreign investment just to a certain profitable point; it encourages it to a point of continuing and ever increasing profitability.

K. DUE PROCESS

No further discussion is appropriate.

L. IMPOSITION OF WATER'S EDGE

FTB's position has merit. Plaintiffs assert (POB Page 111-113) that this court should impose upon FTB the AL/SA method. This court can only act negatively, to find the WWCR method invalid as applied to Plaintiffs and other similarly situated; it cannot legislate. In their closing brief (PCB Page 81), Plaintiffs appear to retreat from this effort. In any event, the suggestion is rejected.

V

CONCLUSION

The tax as sought to be imposed here by FTB is unconstitutional. The claim for refund will be allowed.

Unless a specific request is filed by either party as in CCP Section 632 provided, this Intended Decision shall be deemed in full compliance with that Section's requirement for a Statement of Decision.

DATED: JUNE 12, 1987

GEORGE E. PARAS

George E. Paras
Judge of the Superior Court, Pro Tem

EXHIBIT 1

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SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the Country of England,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California

Defendant.

BARCLAYS BANK OF CALIFORNIA
a California Corporation,

Plaintiff,

vs.

FRANCHISE TAX BOARD,
an agency of the State of California,

Defendant.

No. 32509 & No. 325061 (Consolidated for Purposes of Trial)

ENDORSED: November 3, 1986
JOYCE RUSSELL SMITH, CLERK
By Kathleen L. Burgess, Deputy

SCHEDULE I

JOINT STIPULATION OF FACTS
Trial Date 11-10-86

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following facts are agreed and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

The parties will make any computations necessary for inclusion in appropriate findings after the court's decision in this matter.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS

The following facts are agreed and undisputed:

1. During income year ending September 30, 1977 (hereafter referred to as income year 1977), plaintiff Barclays Bank International Limited ("BBI") was a corporation organized and existing under the laws of England and was qualified to do, and was doing, business as a banking agency in San Francisco, California.

2. During income year 1977, BBI was engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories.

3. During income year 1977, BBI itself operated through banking agencies or branches in approximately thirty-three (33) nations or territories outside the United Kingdom. BBI operated in the United States through branches or agencies located in the states of Georgia, Massachusetts, Illinois, New York and California.

4. During income year 1977, BBI owned more than fifty percent (50%) of over seventy (70) subsidiaries which operated in approximately thirty-four (34) nations or territories outside the United Kingdom.

5. During income year 1977, BBI owned banking subsidiaries which were organized and operated in the United States, including Barclays Bank of New York ("BBNY") and Barclays Bank of California ("Barcal").

6. During income year 1977, BBI was a wholly-owned subsidiary of Barclays Bank Limited ("BBL"), a United Kingdom clearing bank, organized and existing under the laws of England.

7. During the income year 1977, BBL owned, directly or indirectly, in addition to BBI and its subsidiaries, over one hundred forty (140) subsidiaries, none of which was incorporated under the laws of the United States or any political subdivision or territory thereof, and none of which operated in California or in the United States.

8. During the income year 1977, BBL and all subsidiaries of which it owned more than fifty percent (50%) of the stock, directly or indirectly, including BBI and Barcal, operated in over sixty countries or territories. A list of these subsidiaries showing country of incorporation and equity ownership is attached as trial Exhibit 8. BBL and such subsidiaries will be referred to as the Barclays Group and individually or collectively as a member or members of the Barclays Group, respectively.

9. During income year 1977, Barcal, a California banking corporation and a wholly-owned subsidiary of BBI, was engaged in the commercial banking business in the State of California where it operated through forty-nine (49) branch banking offices.

10. On January 1, 1985, pursuant to the United Kingdom's Companies Act and the Barclays Bank Act 1984, BBL was merged with BBI under the name Barclays Bank PLC, and a holding company, Barclays PLC, became the parent of Barclays Bank PLC.

11. Defendant Franchise Tax Board ("FTB") is an agency of the State of California. The FTB is vested with the power and duty to administer the Bank and Corporation Franchise Tax Law of the State of California.

12. For the income year 1977, BBI prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the Franchise Tax Board of $14,447.54.

13. For the income year 1977, Barcal prepared and filed a California Bank and Financial Tax Return and paid a total tax liability to the FTB of $541,276.49.

14. The FTB conducted an audit of the California tax returns of BBI and Barcal for the income year 1977. Upon audit the FTB determined that BBI and Barcal were part of a worldwide unitary business conducted by all members of the Barclays Group.

15. Based upon its determination that BBI and Barcal were a part of a worldwide unitary business conducted by all the members of the Barclays Group, the FTB issued Notices of Additional Tax Proposed to be Assessed (hereafter Notices) as follows: to BBI in the amount of $4,076.02 for a total tax for the income year of 1977 of $18,523.56; to Barcal in the amount of $254,699.45 for a total tax for the income year of 1977 of $795,975.94.

16. The FTB's calculation of BBI's and Barcal's California tax liability was set forth in Schedule 1 of the attachment to the Notices as follows:

BUSINESS INCOME:		
INCOME BEFORE TAXES, SECURITIES GAINS/LOSSES, MINORITY INTERESTS AND EXTRAORDINARY ITEMS	pg. 10 Pros.	£270,300,000
SECURITIES GAINS/(LOSSES)	pg. 30 Bbl A/R	(2,400,000)
EXTRAORDINARY ITEMS	pg. 23 Bbl A/R	300,000
TOTAL POUND STERLING		268,200,000
CONVERSION RATE		1.7025
BUSINESS INCOME — IN U.S. DOLLARS		$456,610,500

	BBI	Barcal
APPORTION TO CALIFORNIA	$149,083	$6,406,245
TAX RATE	.12425	.12425
TAX	$ 18,524	$ 795,976
TAX PREVIOUSLY ASSESSED	$ 14,448	$ 541,276
ADDITIONAL TAX	$ 4,076	$ 254,700

17. The reference to "page 10 PROS" is a reference to page 10 of the Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. The references to pages 30 and 23 respectively were references to the BBL Reports and Accounts for 1977. The reference to "TAX PREVIOUSLY ASSESSED" means the tax paid by BBI and Barcal on filing, net of certain refunds.

18. BBI and Barcal filed protests of the proposed assessments in 1982, which protests were timely. BBI had originally filed its tax returns for the income year 1977 on the basis that it was part of a unitary business composed of itself and its subsidiaries. BBI protested the tax on the basis, *inter alia*, that the correct method upon which to compute its tax liability was separate entity/arm's length accounting.

19. Barcal timely filed a protest of the proposed assessment. It had originally filed its tax returns for the income year 1977 on a separate entity/arm's length accounting basis, and protested the

additional assessment on the basis, *inter alia*, that the correct method upon which to compute its tax was separate entity/arm's length accounting.

20. On May 21, 1984, BBI paid the additional proposed tax of $4,076.02 and BBI's administrative protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

21. On October 31, 1983, Barcal paid additional proposed tax of $250,000.00 and Barcal's protest was converted by operation of law into a claim for refund of taxes. It is upon this claim that the instant litigation is based.

22. After the issuance by the FTB of the Notices and the filing by BBI and Barcal of the protest, the FTB adjusted the audit schedules as follows:

BUSINESS INCOME PER AUDIT	£268,200,000
LESS: INCOME OF ASSOCIATED COMPANIES	(39,700,000)
ADD: DIVIDENDS FROM ASSOCIATED COMPANIES	5,105,000
ANZ GROUP DIVIDEND	735,000
ADD: ACCOUNTING METHOD CHANGE (AMORTIZATION — FROM AGREEMENT PRIOR YRS)	1,429,000
ADD: EXTRAORDINARY INCOME, AMOUNT THAT HAD BEEN EXCLUDED (ATTRIBUTABLE TO MINORITY SHAREHOLDERS)	100,000
REVISED BUSINESS INCOME — POUND STERLING	£235,869,000
CONVERSION RATE	1.7025
REVISED BUSINESS INCOME — U.S. $	$401,566,973
REVISED APPORTIONMENT % — BBI	.0003232
INCOME APPORTIONED TO CALIFORNIA	129,786
TAX RATE	12.425%
TOTAL REVISED TAX	16,126
PREVIOUSLY ASSESSED	14,448
ADDITIONAL TAX — REVISED BBI	$ 1,678
REVISED APPORTIONMENT % — BARCAL	.0139032
INCOME APPORTIONED TO CALIFORNIA	5,583,066
TAX RATE	12.425%
TOTAL REVISED TAX	693,696
PREVIOUSLY ASSESSED	541,276
ADDITIONAL TAX — REVISED BARCAL	$ 152,420

23. Board issued Notices of Action on Taxpayer's Protest to BBI and Barcal on February 15, 1985, for the amounts set forth in paragraph 22.

24. The payment of $250,000.00 made by Barcal on October 31, 1983 was credited by the Board against Barcal's additional tax as revised of $152,419.01. The remaining amount was credited to the interest owing on such liability and on April 19, 1985 an additional payment of $25,670.82 with respect to the interest owing on the $152,419.01 tax was made and credited to Barcal's account. The total amount of refund being sought by Barcal in this case is tax in the amount of $152,419.01 and interest of $123,251.81.

25. Payment of $4,076.02 made by BBI on May 21, 1984 was credited against the revised tax of $1,678.46 and interest on such amounts of $1,505.06. The remaining amount of $892.50 was subsequently refunded to BBI with interest as provided by law. These additional payments of $1,678.46 of tax and $1,505.06 of interest are the amounts for which BBI is seeking a refund in this action.

26. The FTB, through its attorney Marvin J. Halpern ("Halpern"), and BBI and Barcal, through their attorney Joanne M. Garvey ("Garvey"), have corresponded regarding, *inter alia*, plaintiffs' respective Section 25137 petitions for the income years ending September 30, 1977, 1978 and 1979 and December 1, 1979. In addition members of the FTB or the FTB staff have drafted certain documents concerning Section 25137 petitions. These documents include:

26a. Letter from Garvey to Halpern dated May 18, 1984.

26b. Letter from H. Barry Berlin to California Franchise Tax Board, dated May 22, 1984.

26c. Photocopies of checks numbers 45007-45009 of BBI, dated May 21, 1984 drawn on Barclays Bank International Limited account payable to the Franchise Tax Board.

26d. Letter from Halpern to Garvey dated June 22, 1984.

26e. Letter from Garvey to Halpern dated June 28, 1984.

26f. Letter from Halpern to Garvey dated July 24, 1984.

26g. Letter from Garvey to Halpern dated September 11, 1984.

26h. Letter (via Telex) from Garvey to Halpern dated November 9, 1984.

26i. Letter from Halpern to Garvey dated January 28, 1985.

26j. FTB's Notice of Action on Taxpayer's Protest to Barcal, dated February 15, 1985.

26k. FTB's Notice of Action on Taxpayer's Protest to BBI, dated February 15, 1985.

26l. Letter from Garvey to Halpern, dated June 28, 1985.

26m. Letter from Halpern to Garvey dated January 8, 1986.

26n. Exhibit No. 3 to Marvin Halpern's deposition taken January 16-17, 1986, entitled "Statement of the Franchise Tax Board Pertaining to Section 25137 Petitions."

26o. Memorandum from Martin Huff to Walter Harvey, concerning "Petitions for Relief under Section 25137 Bank and Corporation Tax Law," dated June 23, 1977.

26p. Memorandum from Benjamin F. Miller to Martin Huff, Executive Officer, concerning "Meeting with Dennis Amundsun, Director Department for Economic and Business Development," dated March 21, 1978.

26q. Memorandum from Marvin J. Halpern to Glenn L. Rigby dated July 25, 1984.

26r. Letter from R.E. Gilbert to the California Franchise Tax Board, dated October 31, 1983.

27. For purposes of this litigation only, BBI and Barcal agree that for income year 1977 they were members of a worldwide unitary business within the meaning of Revenue and Taxation Code Section 25101, *et. seq.*, composed of the members of the Barclays Group.

28. On September 23, 1983, United States Secretary of Treasury, Donald T. Regan, announced the establishment of the Worldwide Unitary Taxation Working Group ("Working Group").

29. The Final Report of the Worldwide Unitary Taxation Working Group, Chairman's Report and Supplemental Views, August 1984, was transmitted to the President of the United States on August 31, 1984.

30. Among those testifying before, or submitting reports to, the Working Group or the Task Force of the Working Group were:

30a. Statement of the United Kingdom before the United States Treasury Working Group on Worldwide Unitary Taxation.

30b. Presentation by Mr. Barry Pollard, Inland Revenue, on United Kingdom Experience of Operating the Arms Length Principle With Special Reference to Transfer Pricing Enquiries.

30c. Statement of Canada before the United States Worldwide Unitary Taxation Working Group.

30d. Submission of the Australian Government to the U.S. Task Force on Unitary Taxation, dated January 4, 1984.

31. Trial Exhibit 31 to this stipulation is a true and accurate summary chart of the country of incorporation and the financial operating profit in pounds sterling of the members of the Barclays Group as set forth in the business records of the companies comprising the Group, prepared in the ordinary course of business and used, among other things, for the preparation of the Reports and Accounts of the Barclays Group.

32. Foreign governments, on their own behalf or as the representatives of official governmental bodies such as the European Economic Community (EEC), have sent communications (collectively trial Exhibit 32) to the United States government and to the several states of the United States, including California, expressing objections to use by the states, including California, of the worldwide combined reporting unitary method of state taxation. Some of these are:

32a. Letter from Hon. Nigel Lawson, Chancellor of the Exchequer for the United Kingdom to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated July 12, 1983.

32b. Demarche from Italy, as President of the EEC, on behalf of the Nine European Economic Community Governments to the Department of State, Washington, D.C., dated March 19, 1980.

32c. Demarche No. 51 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated March 25, 1980.

32d. Demarche No. 211 from the United Kingdom, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington, D.C., dated October 30, 1981.

32e. Demarche No. 692 from the Embassy of Canada to the Department of State, Washington, D.C., dated December 22, 1981.

32f. Demarche No. 83 from the United Kingdom Embassy to the Department of State, Washington, D.C., dated May 18, 1982.

32g. Demarche No. 283 from the Embassy of Canada to the Department of State, Washington, D.C., dated June 14, 1982.

32h. Demarche from the Government of Belgium as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated June 29, 1982.

32i. Demarche from Greece, as President of the EEC, on behalf of the ten European Economic Community Governments to the Department of State, Washington, D.C., dated August 1, 1983.

32j. Demarche No. 481 from the Embassy of Canada to the Department of State, Washington, D.C., dated September 28, 1983.

32k. Demarche No. 383/83 from the Embassy of Australia to the Department of State, Washington, D.C., dated November 7, 1983.

32l. Demarche No. 461.20-LJ/hu from the Embassy of Switzerland to the Department of State, Washington, D.C., dated November 15, 1983.

32m. Demarche from the Federal Republic of Germany to the Department of State, Washington, D.C., dated November 28, 1983.

32n. Demarche No. EA-14533 from the Embassy of the Kingdom of the Netherlands to the Department of State, Washington, D.C., dated December 21, 1983.

32o. Demarche from the Embassy of Belgium on behalf of the ten European Economic Community Governments, the European Commission and the Embassies of Australia, Canada, Japan and Switzerland to the Department of State, Washington, D.C., dated January 25, 1984.

32p. Demarche from the Embassy of Belgium to the Department of State, Washington, D.C., dated January 25, 1984.

32q. Demarche No. 634 from the Embassy of Canada to the Department of State, Washington, D.C., dated February 27, 1984.

32r. Aide-memoire from the Government of Japan to the United States Government dated June 6, 1984.

32s. Official correspondence from the Hon. Marc Lalonde, Minister of Finance for Canada to the United States Secretary of the Treasury, Hon. Donald T. Regan, dated August 11, 1983.

32t. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Bangter, Governor of the State of Utah, dated February 15, 1985.

32u. Letter from J.L. Beaven, United Kingdom Consul-General to the United States, to the Hon. Willie L. Brown, Jr., Speaker of the California Assembly, dated June 18, 1984.

32v. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Honorable Richard D. Lamm, Governor of the State of Colorado, dated January 25, 1985.

32w. Letter from W. Wachtmeister, Swedish Ambassador to the United States, and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, Norway, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. George A. Sinner, Governor of the State of North Dakota, dated March 18, 1985.

32x. Letter from Jacques S. Roy of the Embassy of Canada to the Hon. Robert Graham, Governor of the State of Florida, dated May 30, 1984.

32y. Letter from J. Raoul Schoumaker of the Embassy of Belgium and the Governments of Australia, Austria, Belgium, Canada, Denmark, Finland, France, the Federal Republic of Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Kingdom of the Netherlands, Sweden, Switzerland, the United Kingdom and the Commission of the European Communities to the Hon. Robert Graham, Governor of the State of Florida, dated November 28, 1984.

32z. Letter from H.G. Walsh, Counsellor (Economic) British Embassy Washington, D.C. to the Honorable Edmund G. Brown, Governor of the State of California, dated October 30, 1981.

32aa. Letter from Christopher E. F. Davis, Consul Canadian Consulate, San Francisco, California to Gerald Goldberg, Executive Officer Franchise Tax Board of California, dated January 26, 1984.

32bb. Letter from J. L. Beaven, Her Majesty's Consul-General to the Honorable George Deukmejian, Governor of California, dated June 21, 1983.

32cc. Letter from the United Kingdom Chancellor of the Exchequer to the Secretary of the United States Treasury dated June 20, 1985.

32dd. Undated Memorandum from the Netherlands Government to the Governor of California.

32ee. Letter from the Hon. Pierre Trudeau to Hon. Ronald Reagan, President of the United States, dated September 24, 1983.

33. The following documents pertaining to treaties of Friendship, Commerce, and Navigation were provided to Benjamin F. Miller, Counsel for Multistate Tax Affairs for the FTB, by the Department of State:

33a. The first page and pages 15 and 16 of a Memorandum to the Embassy at Chungking for Use in Negotiating Treaty of Friendship, Commerce and Navigation. These pages, constituting the only pages received of the above-mentioned document by the FTB were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33b. The first page and pages 16 through 19 of a Memorandum to the American Embassy at Rio de Janeiro for Use in Negotiating Treaty of Friendship, Commerce and Navigation Between the United States and Brazil. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33c. The cover page and pages ii, 19, 20, 21, 202 and 203 of a preliminary draft of a study entitled *Standard Draft Treaty of Friendship, Commerce and Navigation* prepared under contract to the Department of State by Charles H. Sullivan. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to a letter dated August 22, 1980 and signed by Stuart E. Benson, Acting Assistant Legal Advisor, Office of the Legal Advisor, Department of State, addressed to D. R. Milton, Vice President Tax, Shell Oil Company, Houston, Texas, carbon copy to Benjamin F. Miller, Franchise Tax Board, State of California.

33d. Pages 13a through 15 of Annotated Draft FCN for Portugal prepared by Herman Walker. These pages, constituting the only pages received of the above-mentioned document by the FTB, were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33e. HICOG Bonn Despatch No. 2255 of February 17, 1954, pages 1 through 5 inclusive, with two page attachment No. 1868. These documents were enclosures to the letter dated August 22, 1980 referred to in paragraph 33(c).

33f. A three page Airgram of the Department of State dated July 3, 1983 concerning FCN Treaty with the Netherlands, and replying to Embassy dispatch 1472. This document was an enclosure to a letter dated August 28, 1980, from Stuart E. Bensen, Acting Assistant, Legal Advisor, Office of the Legal Advisor, addressed to D.R. Milton, Vice President of Tax, Shell Oil Company, Houston, Texas, carbon copy to Benjamin F. Miller, Franchise Tax Board.

33g. Letter dated February 11, 1981 from Theodore W. Kassinger, Attorney Advisor, Office of Assistant Legal Advisor for Economic and Business Affairs, Department of State.

34. On July 9-10, 1985, the Parliament of the United Kingdom debated and unanimously passed legislation in Clause 27 of the Finance Act of 1985. The proceedings of Parliament are truly and accurately reported in the House of Commons Official Report, Parliamentary Debates (Hansard), Wednesday 10 July 1985, Volume 82, No. 152.

35. The United Kingdom's Finance Act of 1985.

36. There have been discussions and debates in, and documents presented to, the United States Congress concerning the use by the states of worldwide combined reporting, some of which are reported as follows:

36a. Statement of Senators Wilson and Mathias and Statement by the President of the United States in support of the Unitary Tax Repealer Act. 131 Cong. Rec. 17975-17978 (1985).

36b. Executive Session and Statement of Senator Hiyakawa regarding consideration of the United Kingdom-United States treaties. 125 Cong. Rec. 17427-17435, 17796 (1979).

36c. Executive session regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18402-18430 (1978).

36d. Executive session continued regarding consideration of tax convention with the United Kingdom. 124 Cong. Rec. 18651-18670, 18709-18712 and 19076-19078 (1978).

36e. Introduction of H.R. 3980 by Hon. John J. Duncan as reported in the Congressional Record of December 19, 1985 on pages E5754 and 5755 (extension of remarks).

37. Various committees of the United States Congress have held hearings on the issues of state taxation, including the use by the states of worldwide combined reporting, which committees' proceedings, some of which have been transcribed or which committees have issued reports, as follows:

37a. Committee on Ways and Means, 95th Congress, 1st Sess., Recommendations of the Task Force on Foreign Source Income (Comm. Print 1977).

37b. Senate Committee on Foreign Relations, Third Protocol to the 1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, as Amended, S. Doc. No. 5, 96th Congress, 1st Sess. (1979).

37c. Tax Treaties With the United Kingdom, the Republic of Korea, and the Republic of the Philippines, 1977: Hearings Before the Senate Committee on Foreign Relations, 96th Congress, 1st Sess. (1977).

37d. State Taxation of Foreign Source Income, 1980: Hearings on H.R. 5076 Before the House of Representatives Committee on Ways and Means, 86th Congress, 2d Sess. (1980).

37e. State Taxation of Interstate Commerce and Worldwide Corporate Income, 1980: Hearings on S. 983 and S. 1688 Before the Subcomm. on Taxation and Debt Management Generally of the Senate Comm. on Finance, 96th Congress, 2d Sess. (1980).

37f. Unitary Taxation, 1984: Hearings before the Subcomm. on International Economic Policy of the Senate Foreign Relations Comm., 98th Cong., 2d Sess. (1984).

37g. Interstate Taxation, S. 2173: Hearings before the Senate Committee on the Judiciary, 95th Cong., 1st and 2nd Sess. (1977-1978).

38. Various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the states' use of worldwide combined reporting. Some of these bills are:

38a. H.R. 11798 (Willis) (1965)

38b. S. 916 (Ribicoff) (1969)

38c. S. 317 (Ribicoff) (1971)

38d. S. 4080 (Mathias) (1972)

38e. S. 2173 (Mathias) (1977)

38f. S. 1688 (Mathias) (1979)

38g. H.R. 5076 (Conable) (1979)

38h. H.R. 5903 (Satterfield) (1979)

38i. H.R. 8277 (Broyhill) (1980)

38j. H.R. 1983 (Conable) (1981)

38k. H.R. 6402 (Rodino) (1982)

38l. H.R. 2918 (Conable) (1983)

38m. H.R. 3243 (Frenzel) (1983)

38n. S. 1225 (Mathias) (1983)

38o. H.R. 4940 (Wyden) (1984)

38p. H.R. 6146 (Mica) (1984)

38q. S. 3061 (Hawkins) (1984)

38r. H.R. 3980 (Duncan) (1985)

38s. S. 1113 (Mathias) (1985)

38t. S. 1974 (Wilson) (1985)

39. The FTB and various committees of the California State Legislature have held hearings on California's use of world-wide combined reporting, some of which have been transcribed, as follows:

39a. Hearing of State of California Franchise Tax Board, Monday, August 22, 1977, 9:30 a.m.

39b. Hearing of State of California Franchise Tax Board, Tuesday, July 12, 1977, 10:00 a.m.

39c. Hearing, Assembly Revenue and Taxation Committee, Willie L. Brown, Jr., Chairman, Los Angeles, November 1979.

39d. Interim Hearing, Assembly Committee on Revenue and Taxation, San Diego, November 7, 1980.

40. As of January 30, 1986, the United States was a party to income tax treaties for the avoidance of double taxation with thirty-three (33) countries, as follows:

40a. Convention between the Government of the United States of America and the Government of Australia for the Avoidance of Double Taxation, signed August 6, 1982, entered into force October 31, 1983.

40b. Convention between the Government of the United States of America and the Government of Austria for the Avoidance of Double Taxation, signed October 25, 1956, entered into force October 10, 1957.

40c. Convention between the Government of the United States of America and the Government of Belgium for the Avoidance of Double Taxation, signed July 9, 1970, entered into force October 13, 1972.

40d. Convention between the Government of the United States of America and the Government of Canada for the Avoidance of Double Taxation, signed September 26, 1980, amended by protocols signed June 14, 1983 and March 23, 1984, entered into force August 16, 1984.

40e. Convention between the Government of the United States of America and the Government of Denmark for the Avoidance of Double Taxation, signed May 6, 1948, entered into force December 1, 1948.

40f. Convention between the Government of the United States of America and the Government of Egypt for the Avoidance of Double Taxation, signed August 24, 1980, entered into force December 31, 1981.

40g. Convention between the Government of the United States of America and the Government of Finland for the Avoidance of Double Taxation, signed March 6, 1970, entered into force February 28, 1971.

40h. Convention between the Government of the United States of America and the Government of France for the Avoidance of Double Taxation, signed June 28, 1967, entered into force August 11, 1968, modified by protocol signed October 12, 1970, entered into force February 21, 1971, modified by protocol dated November 24, 1978, entered into force October 27, 1979.

40i. Convention between the Government of the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation, signed July 22, 1954, entered into force December 20, 1954, modified by protocol signed September 17, 1965, entered into force December 27, 1965.

40j. Convention between the Government of the United States of America and the Government of Greece for the Avoidance of Double Taxation, signed April 20, 1953, amended by protocol dated April 20, 1953, entered into force December 30, 1953.

40k. Convention between the Government of the United States of America and the Government of Hungary for the Avoidance of Double Taxation, signed February 12, 1979, entered into force September 18, 1979.

40l. Convention between the Government of the United States of America and the Government of Iceland for the Avoidance of Double Taxation, signed May 7, 1975, entered into force December 26, 1975.

40m. Convention between the Government of the United States of America and the Government of Ireland for the Avoidance of Double Taxation, signed September 13, 1949, entered into force December 20, 1951.

40n. Convention between the Government of the United States of America and the Government of Italy for the Avoidance of Double Taxation, signed March 30, 1955, entered into force October 26, 1956.

40o. Convention between the Government of the United States of America and the Government of Jamaica for the Avoidance of Double Taxation, signed May 21, 1980, amended by protocol signed May 21, 1980, entered into force December 29, 1981.

40p. Convention between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation, signed March 8, 1971 entered into force July 9, 1972.

40q. Convention between the Government of the United States of America and the Government of Korea for the Avoidance of Double Taxation, signed June 4, 1976, entered into force October 29, 1979.

40r. Convention between the Government of the United States of America and the Government of Luxembourg for the Avoidance of Double Taxation, signed December 18, 1962, entered into force December 22, 1984.

40s. Convention between the Government of the United States of America and the Government of Malta for the avoidance of Double Taxation, signed March 21, 1980, entered into force May 18, 1982.

40t. Convention between the Government of the United States of America and the Government of Morocco for the Avoidance of Double Taxation, signed August 1, 1977, entered into force December 30, 1981.

40u. Convention between the Government of the United States of America and the Government of the Kingdom of the Netherlands for the Avoidance of Double Taxation, signed April 29, 1948, entered into force December 1, 1948, as modified by supplementary convention signed December 30, 1965, entered into force July 8, 1966.

40v. Convention between the Government of the United States of America and the Government of New Zealand for the Avoidance of Double Taxation, signed July 23, 1982, entered into force November 2, 1983.

40w. Convention between the Government of the United States of America and the Government of Norway for the Avoidance of Double Taxation, signed December 3, 1971, entered into force November 29, 1972, modified by protocol signed September 19, 1980, entered into force December 15, 1981.

40x. Convention between the Government of the United States of America and the Government of Pakistan for the Avoidance of Double Taxation, signed July 1, 1957, entered into force May 21, 1959.

40y. Convention between the Government of the United States of America and the Government of the Philippines for the Avoidance of Double Taxation, signed October 1, 1976, entered into force October 16, 1982.

40z. Convention between the Government of the United States of America and the Government of Poland for the Avoidance of Double Taxation, signed October 8, 1974, entered into force June 22, 1976.

40aa. Convention between the Government of the United States of America and the Government of Romania for the Avoidance of Double Taxation, signed December 4, 1973, entered into force February 26, 1976.

40bb. Convention between the Government of the United States of America and the Government of Sweden for the Avoidance of Double Taxation, signed March 23, 1939, entered into force November 14, 1939, modified by supplementary convention signed October 22, 1963, entered into force September 11, 1964.

40cc. Convention between the Government of the United States of America and the Government of Switzerland for the Avoidance of Double Taxation, signed May 24, 1951, entered into force September 22, 1951.

40dd. Convention between the Government of the United States of America and the Government of Trinidad and Tobago for the Avoidance of Double Taxation, signed January 9, 1970, entered into force December 30, 1970.

40ee. Convention between the Government of the United States of America and the Government of the Republic of South Africa for the Avoidance of Double Taxation, signed December 13, 1946, entered into force July 15, 1952, modified by supplementary protocol signed July 14, 1950, entered into force July 15, 1952.

40ff. Convention between the Government of the United States of America and the Government of the Union of Soviet Socialist Republics for the Avoidance of Double Taxation, signed June 20, 1973, entered into force January 29, 1976.

40gg. Convention between the Government of the United States of America and the Government of the Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed December 31, 1975, entered into force April 25, 1980, modified by notes exchanged on April 13, 1976, amended by first protocol signed August 26, 1976, second protocol signed March 31, 1977, and third protocol signed March 15, 1979, all entered into force July 25, 1980.

41. As of December 16, 1985, the United Kingdom was a party to seventy-eight (78) treaties for the avoidance of double taxation on income, as follows:

41a. Double Taxation Relief (Antigua) Order 1947 (S.R. & O 1947 No. 2865), amended (S.I. 1968 No. 1096).

41b. Double Taxation Relief (Australia) Order 1967 (S.I. 1968 No. 305), protocol (S.I. 1980 No. 707).

41c. Double Taxation Relief (Austria) Order 1970 (S.I. 1947 No. 1947), protocol 1980 (S.I. 1979 No. 117).

41d. Double Taxation Relief (Bangladesh) Order 1979 (S.I. 1980 No. 1947), protocol 1980 (S.I. 1979 No. 708).

41e. Double Taxation Relief (Barbados) Order 1970 (S.I. 1970 No. 952), protocol 1973 (S.I. 1973 No. 2096).

41f. Double Taxation Relief (Belgium) Order 1967 (S.I. 1970 No. 636).

41g. Double Taxation Relief (Belize) Order 1947 (S.R. & O 1947 No. 2866), amended 1962 (S.I. 1968 No. 573), amended 1973 (S.I. 1973 No. 2097).

41h. Double Taxation Relief (Botswana) Order 1977 (S.I. 1978 No. 183).

41i. Double Taxation Relief (Brunei) Order 1950 (S.I. 1950 No. 1977), amended 1968 (S.I. 1968 No. 306), amended 1973 (S.I. 1973 No. 2098).

41j. Double Taxation Relief (Burma) Order 1950, protocol 1951 (S.I. 1952 No. 751).

41k. Double Taxation Relief (Canada) Order 1978 (S.I. 1980 No. 709), protocol 1980 (S.I. 1980 No. 1528), protocol (S.I. 1985 No. 1996).

41l. Double Taxation Relief (China) Order 1984 (S.I. 1984 No. 1826).

41m. Double Taxation Relief (Cyprus) Order 1974 (S.I. 1975 No. 425), protocol 1980 (S.I. 1980 No. 1529).

41n. Double Taxation Relief (Denmark) Order 1980 (S.I. 1980 No. 1960).

41o. Double Taxation Relief (Dominican Republic) Order 1949 (S.I. 1949 No. 359), amended 1968 (S.I. 1968 No. 1098).

41p. Double Taxation Relief (Egypt) Order 1980 (S.I. 1980 No. 1091).

41q. Double Taxation Relief (Falkland Islands) Order 1984 (S.I. 1984 No. 363).

41r. Double Taxation Relief (Faroe Islands) Order 1950 (S.I. 1950 No. 1195), extended 1960 (S.I. 1961 No. 579), protocol 1969 (S.I. 1969 No. 1068), extended 1970 (S.I. 1971 No. 717), protocol 1973 (S.I. 1973 No. 1326), extended 1975 (S.I. 1975 No. 2190).

41s. Double Taxation Relief (Fiji) Order 1975 (S.I. 1976 No. 1342).

41t. Double Taxation Relief (Finland) Order 1969 (S.I. 1970 No. 153), protocol 1979 (S.I. 1980 No. 710), protocol 1984 (S.I. 1985 No. 1997).

41u. Double Taxation Relief (France) Order 1968 (S.I. 1968 No. 1869), protocol 1973 (S.I. 1973 No. 1328).

41v. Double Taxation Relief (Gambia) Order 1980 (S.I. 1980 No. 1963).

41w. Double Taxation Relief (Federal Republic of Germany) Order 1964 (S.I. 1967 No. 25), protocol 1970 (S.I. 1971 No. 874).

41x. Double Taxation Relief (Ghana) Order 1977 (S.I. 1978 No. 785).

41y. Double Taxation Relief (Greece) Order 1953 (S.I. 1954 No. 142).

41z. Double Taxation Relief (Grenada) Order 1949 (S.I. 1949 No. 361), amended 1968 (S.I. 1968 No. 1867).

41aa. Double Taxation Relief (Guernsey) Order 1952 (S.I. 1952 No. 1215).

41bb. Double Taxation Relief (Hungary) Order 1977 (S.I. 1978 No. 1056).

41cc. Double Taxation Relief (India) Order 1981 (S.I. 1981 No. 1120).

41dd. Double Taxation Relief (Indonesia) Order 1975 (S.I. 1975 No. 2191).

41ee. Double Taxation Relief (Republic of Ireland) Order 1976 (S.I. 1976 No. 2151), protocol 1976 (S.I. 1976 No. 2152).

41ff. Double Taxation Relief (Isle of Man) Order 1955 (S.I. 1955 No. 1205).

41gg. Double Taxation Relief (Israel) Order 1962 (S.I. 1962 No. 616), protocol 1970 (S.I. 1971 No. 391).

41hh. Double Taxation Relief (Italy) Order 1960, exchange of notes 1960 (S.I. 1962 No. 2787), protocol 1969 (S.I. 1973 No. 1763).

41ii. Double Taxation Relief (Jamaica) Order 1973 (S.I. 1973 No. 1329).

41jj. Double Taxation Relief (Japan) Order 1969, exchange of notes 1969 (S.I. 1970 No. 1948), protocol 1980 (S.I. 1980 No. 1530).

41kk. Double Taxation Relief (Jersey) Order 1952 (S.I. 1952 No. 1216).

41ll. Double Taxation Relief (Kenya) Order 1973, protocol 1976, exchange of notes 1977 (S.I. 1977 No. 1299).

41mm. Double Taxation Relief (Kiribati and Tuvalu) Order 1950 (S.I. 1950 No. 750), amended 1968 (S.I. No. 309), amended 1974 (S.I. 1974 No. 1271).

41nn. Double Taxation Relief (Korea) Order 1977, protocol 1977 (S.I. 1978 No. 786).

41oo. Double Taxation Relief (Lesotho) Order 1949 (S.I. No. 2197), amended 1968 (S.I. 1968 No. 1868).

41pp. Double Taxation Relief (Luxembourg) Order 1967 (S.I. 1968 No. 1100), protocol 1978 (S.I. 1980 No. 567), protocol 1983 (S.I. 1984 No. 364).

41qq. Double Taxation Relief (Malawi) Order 1955 (S.I. 1956 No. 619), amended 1964 (S.I. 1964 No. 1401), amended 1968 (S.I. 1968 No. 1101), amended 1978 (S.I. 1978 No. 302).

41rr. Double Taxation Relief (Malaysia) Order 1973, protocol 1973 (S.I. 1973 No. 1330).

41ss. Double Taxation Relief (Malta) Order 1962 (S.I. 1962 No. 639), amended 1974 (S.I. 1975 No. 426).

41tt. Double Taxation Relief (Mauritius) Order 1981 (S.I. 1981 No. 1121).

41uu. Double Taxation Relief (Montserrat) Order 1947 (S.I. 1947 No. 2868), amended 1968 (S.I. 1968 No. 576).

41vv. Double Taxation Relief (Namibia) Order 1962 (S.I. 1962 No. 2352), extended 1962 (S.I. 1962 No. 2788), protocol 1967 (S.I. 1967 No. 1489), extended 1967 (S.I. 1967 No. 1460).

41ww. Double Taxation Relief (Netherlands) Order 1980 (S.I. 1980 No. 1961), protocol 1983 (S.I. 1983 No. 1902).

41xx. Double Taxation Relief (Netherlands Antilles) Order 1967 (S.I. 1968 No. 577), extended 1970 (S.I. 1970 No. 1949).

41yy. Double Taxation Relief (New Zealand) Order 1983, exchange of notes 1983 (S.I. 1984 No. 365).

41zz. Double Taxation Relief (Norway) Order 1985 (S.I. 1985 No. 1998).

41aaa. Double Taxation Relief (Pakistan) Order 1961 (S.I. 1961 No. 2467).

41bbb. Double Taxation Relief (Philippines) Order 1976 (S.I. 1978 No. 184).

41ccc. Double Taxation Relief (Poland) Order 1976 (S.I. 1978 No. 282).

41ddd. Double Taxation Relief (Portugal) Order 1968 (S.I. 1969 No. 599).

41eee. Double Taxation Relief (Romania) Order 1975, exchange of notes 1976 (S.I. 1977 No. 57).

41fff. Double Taxation Relief (St. Christopher & Nevis (St. Kitts)) Order 1947 (S.I. 1947 No. 2872).

41ggg. Double Taxation Relief (St. Lucia) Order 1949 (S.I. 1949 No. 366), amended 1968 (S.I. 1968 No. 1102).

41hhh. Double Taxation Relief (St. Vincent & Grenadines) Order 1949 (S.I. 1949 No. 367), amended 1968 (S.I. 1968 No. 1103).

41iii. Double Taxation Relief (Sierra Leone) Order 1947 (S.I. 1947 No. 2873), amended 1968 (S.I. 1968 No. 1104).

41jjj. Double Taxation Relief (Singapore) Order 1966 (S.I. 1967 No. 483), protocol 1975, exchange of notes 1975, 1976, 1977 (S.I. 1978 No. 787).

41kkk. Double Taxation Relief (Solomon Islands) Order 1950 (S.I. 1950 No. 748), amended 1968 (S.I. 1968 No. 574), amended 1974 (S.I. 1974 No. 1270).

41lll. Double Taxation Relief (South Africa) Order 1968 (S.I. 1969 No. 864).

41mmm. Double Taxation Relief (Spain) 1975 (S.I. 1976 No. 1919).

41nnn. Double Taxation Relief (Sri Lanka) Order 1979, exchange of notes 1980 (S.I. 1980 No. 713).

41ooo. Double Taxation Relief (Sudan) Order 1975 (S.I. 1979 No. 1719).

41ppp. Double Taxation Relief (Swaziland) Order 1968 (S.I. 1968 No. 380).

41qqq. Double Taxation Relief (Sweden) Order 1983 (S.I. 1984 No. 366), protocol 1984 (S.I. 1984 No. 366).

41rrr. Double Taxation Relief (Switzerland) Order 1977 (S.I. 1978 No. 1408), protocol 1981 (S.I. 1982 No. 714).

41sss. Double Taxation Relief (Thailand) Order 1981 (S.I. 1981 No. 1546).

41ttt. Double Taxation Relief (Trinidad & Tobago) Order 1982 (S.I. 1983 No. 1903).

41uuu. Double Taxation Relief (Tunisia) Order 1982 (S.I. 1984 No. 1336).

41vvv. Double Taxation Relief (Uganda) Order 1952 (S.I. 1952 No. 1213).

41www. Double Taxation Relief (United States of America) Order 1975, exchange of notes 1976, protocol 1976, protocol 1977, protocol 1979 (S.I. 1980 No. 568).

41xxx. Double Taxation Relief (Yugoslavia) Order 1981 (S.I. 1981 No. 1815).

41yyy. Double Taxation Relief (Zambia) Order 1972 (S.I. 1972 No. 1721), protocol 1981 (S.I. 1981 No. 1816).

41zzz. Double Taxation Relief (Zimbabwe) Order 1982 (S.I. 1982 No. 1842).

42. By an exchange of notes dated September 26, 1980, between the Honorable Allan J. MacEachen, Deputy Prime Minister and Minister of Finance of Canada and G. William Miller, Secretary of Treasury of the United States, in conjunction with the execution of the Convention For Avoidance of Double Taxation between the United States and Canada, the Government of Canada set forth its position on the issue of the so-called "unitary apportionment" method used by certain states of the United States and the United States agreed to reopen discussions

with Canada on this subject if an acceptable provision on this subject can be devised.

43. By an exchange of notes dated November 24, 1978, between George S. Vest, Assistant Secretary of State for European Affairs, and Francois de Laboulaye, Ambassador of France, in conjunction with the execution of the protocol dated November 24, 1978, to the Convention for the Avoidance of Double Taxation between the United States and France, the Government of France set forth its position on the so-called "unitary apportionment" method used by certain states of the United States, and the Government of the United States and the Government of the United States agreed to reopen discussions with France on this subject if an acceptable provision on this subject can be devised.

44. In 1963, the Committee on Fiscal Affairs to the Council of the Organization for Economic Co-operation and Development ("OECD") published the Draft Double Taxation Convention on Income and Capital. In 1977, the OECD revised and published its new Model Double Taxation Convention on Income and on Capital. The conventions are both contained in the 1977 Report of the OECD Committee on Fiscal Affairs, "Model Double Taxation Convention on Income and on Capital."

45. In 1977, the Government of the United States of America published its Model Convention For the Avoidance of Double Taxation on Income and Capital. This document was revised in 1981 and is entitled "United States Draft Model Income Tax Treaty."

46. Correspondence, statements or press releases from various government officials throughout the United States have been issued, some of which are as follows:

46a. Letter from Secretary of Treasury, James A. Baker III to the President of the United States Senate regarding the introduction of Unitary Tax Repealer Act, dated December 18, 1985.

46b. Letter from the Honorable Barber B. Conable, Jr. to the Honorable John E. Chapoton with enclosed statement of the Honorable Conable to be submitted to the Unitary Taxation Group's Task Force, dated November 23, 1983.

46c. Letter to the Honorable Barber B. Conable, Jr. from the Honorable Donald C. Lubick, Assistant Secretary of the Treasury regarding unitary taxation, dated April 22, 1980.

46d. Statement by the Honorable Allen Wallis, Under Secretary of State for Economic Affairs concerning the Chairman's Working Group Report, as taken from the Final Report of the Worldwide Unitary Taxation Group, August 1984.

46e. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the Senate Finance Subcommittee on Taxation and Debt Management Generally on S. 983 and S. 1688, dated June 24, 1980.

46f. Statement by the Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy, before the House Ways and Means Committee on H.R. 5076, dated March 31, 1980.

46g. Press release #255 from the Office of the Governor of California regarding California's unitary tax, dated May 1, 1984.

46h. Letter from the Honorable George P. Schultz to the Honorable George Deukmejian regarding unitary taxation, dated January 30, 1986.

46i. Reply from Honorable George Deukmejian to the letter of January 30, 1986, from the Honorable George P. Schultz.

47. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises" (Paris OECD, 1979).

48. The Organization for Economic Co-operation and Development (OECD) issued a report on transfer pricing entitled "Transfer Pricing and Multinational Enterprises, Three Taxation Issues" (Paris OECD, 1984).

49. The administration of Internal Revenue Code Section 482 by the Internal Revenue Service, and its effectiveness generally, has been studied and reported on by certain governmental agencies of the United States, as follows:

49a. Comptroller General of the United States, No. GGD-51-81, Report to the Chairman, House Committee on Ways and Means, IRS Could Better Protect U.S. Tax Interests in Determining the Income of Multinational Corporations (September 30, 1981).

49b. Report to the Associate Commissioner of the Internal Revenue Service, Internal Revenue Service of Study of International Cases Involving Section 482 of the Internal Revenue Code (1982).

50. State taxation of multinational corporations has been the subject of reports, some of which are:

50a. "Key Issues Affecting State Taxation of Multi-jurisdictional Corporate Income Need Resolving", a report to the Chairman of the House Committee on Ways and Means from the Comptroller General of the United States and published on July 1, 1982 in the General Accounting Office.

50b. Report of the Advisory Commission on Intergovernmental Relations, "State Taxation of Multi-national Corporations" dated November 1982.

50c. Report of Advisory On Intergovernmental Relations, "State Taxation of Multinational and Multistate Corporations" dated September 4, 1981.

51. Internal records of members of the Barclays Group were produced by plaintiffs to defendants in discovery, some of which are as follows:

51a. Letter from A. H. Dalton to I. M. Cobbold, Esq., dated August 3, 1979. (000176-000177)

51b. Letter dated P. J. Chapman to G. J. Lyall, Esq., dated April 13, 1983. (000594-000595)

51c. Letter from Price Waterhouse to Secretary, Inland Revenue, dated April 1, 1982. (000631-000633)

51d. Letter from J. A. Dally to Price Waterhouse, dated May 13, 1982. (000630)

51e. BBL Reports and Accounts – 1977. (000256-000308)

51f. BBI Reports and Accounts – 1977. (000221-000255)

51g. Preliminary Prospectus dated March 31, 1981 $125,000,000 Barclays North American Capital Corporation % Guaranteed Capital Notes due 2006. (000424-000521)

51h. Barclays International-World of Banking — List of Offices Nov. 1977. (000309-000423)

51i. Barclays Bank International Limited claim for double tax relief — September 30, 1977. (000639-000646)

51j. Reconciliation between agreed local taxable profit and UK adjusted profit for purposes of double tax relief September 30, 1977. (000801-000828)

51k. A-T Schedule for Barclays Bank of California for the income year 1977. (002064-002092)

51l. Annual Return/Report of Employee Benefit Plan — U.S. Form 5500 and supporting documents. (003131-003160)

51m. Barclays Bank of California U.S. Corporation Income Tax Return for Income Year 1977 — U.S. Form 1120 and supporting documents. (003261-003209)

51n. BBI U.S. Corporate Income Tax for Income Year 1977 — Form 1120F. (003217-003225)

51o. Barclays Bank of California — California tax return for income year ending September 30, 1977. (003226-003250)

51p. BBI California tax return for income year ending September 30, 1977. (003251-003261)

51q. Barclays Group Management Accounts — December 31, 1977. (003610-003614)

51r. Barclays Group-Supporting schedules to financial accounts December 31, 1977. (003615-003629)

51s. The Barclays Group-Divisional Operating Profit; Reconciliation of Financial and Management Results. (003630-003687)

51t. Interest in subsidiaries and associated companies, December 31, 1977.

51u. Consolidation Schedules. (003708-003752)

51v. Letter D. Elvidge, Head Group Taxation Barclays Plc to J.H. Hall, Inland Revenue dated April 14, 1986.

51w. Letter J.H. Hall, Inland Revenue to David Elvidge, Head Group Taxation Barclays Plc, dated April 16, 1986.

This stipulation is made this 9th day of September, 1986.

JOANNE M. GARVEY
LAWRENCE W. JORDAN, JR.
JOAN K. IRION
JORDAN, KEELER & SELIGMAN

JOHN VAN DE KAMP, Attorney General of the State of California
EDWARD P. HOLLINGSHEAD, Supervising Deputy Attorney General

By _____
Joanne M. Garvey
Counsel for Plaintiffs

By _____
Robert Milam
Deputy Attorney General
Counsel for Defendant

CERTIFICATE OF SERVICE BY MAIL

I, Rhoda L. Fone, declare that I am a citizen of the United States, over the age of 18, and not a party to or interested in the within entitled cause; that I am an employee of JORDAN, KEELER & SELIGMAN, and that my business address is 1400 Alcoa Building, One Maritime Plaza, San Francisco, California 94111; that on November 3, 1986, I served the within JOINT STIPULATION OF FACTS by placing a true copy thereof in a sealed envelope with postage fully prepaid, in the United States Post Office mail box, in the City and County of San Francisco, California addressed as follows:

Robert D. Milam, Esq.
Deputy Attorney General
1515 K Street
Sacramento, California 94244-2550

I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 3, 1986, at San Francisco, California.

_____

Rhoda L. Fone

JOHN K. VAN DE KAMP, Attorney
General of the State of California
TIMOTHY G. LADDISH
Supervising Deputy Attorney General
RICHARD E. NEILSEN
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Telephone: (916) 324-5156
Attorneys For Defendant

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK INTERNATIONAL LTD.,
a corporation of the
Country of England,
Plaintiff,

vs.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

BARCLAYS BANK OF CALIFORNIA,
a California Corporation,
Plaintiff,

vs.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

No. 325059 — No. 325061
(Consolidated for Purposes of Trial)

FILED: November 10, 1986
Joyce Russell Smith, Clerk

By S. GODFREY
Deputy

SCHEDULE II

SECOND STIPULATION OF FACTS AND DOCUMENTS

IT IS HEREBY STIPULATED by and between the parties, through their attorneys of record, that the following further facts and documents are agreed to and undisputed. This stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated, and the parties reserve the right to argue the relevance, materiality or weight of any of the facts stipulated.

All further documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties and their authenticity and foundational basis admitted. The documents shall be entered into evidence. Nothing contained in this stipulation shall prevent a party from introducing at trial any other or further evidence. With permission of Court, documents described in paragraphs 32, 40, and 41 hereof will be deemed admitted in evidence in entirety without physically presenting the same at trial. Either party may refer to said documents in summary form or as individual exhibits at trial or on appeal as evidence admitted at trial.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

This stipulation shall only apply to the above-entitled consolidated actions and to any appeals from the judgment of this Court.

FACTS AND DOCUMENTS

The following facts are agreed to and undisputed and the following documents shall be entered into evidence:

28. Continued

28a. Announcement of the Establishment of the Working Group. 48 Fed. Reg. No. 208, page 49570, October 26, 1983.

32. Continued

32ff. Demarche from Greece, as President of the EEC, on behalf of the Ten European Economic Community Governments to the Department of State, Washington D.C. dated September 23, 1983 with attached Note.

32gg. Aide-memoire from the Government of Japan to the United States Government, dated August 11, 1983.

32hh. Demarche from the Embassy of Ireland as President of the EEC, on behalf of the governments of member states and the Commission of the European Communities to the Department of State, dated December 20, 1984.

32ii. Note Verbale of the Delegation of the Commission of the European Communities and the Embassy of Luxembourg on behalf of the EEC, to the Department of State, dated August 8, 1985.

32jj. Demarche from the Ambassador of Luxembourg and the Head of the Delegation of the Commission of the European Communities to the Department of State, dated August 30, 1985 with attached letter to Treasury Secretary Baker dated August 30, 1985 and attached Note Verbal.

32kk. Note on Worldwide Unitary Taxation from J. Raoul Schoumaker, Ambassador of Belgium, on behalf of the Member States of the European Commission and the Ambassador of Australia, Canada, Japan and Switzerland to Under Secretary of State Allen Wallis and Treasury Secretary Donald Regan, dated January 27, 1984 with cover letter, dated January 30, 1984, enclosing the same to Sir Roy Denman, Head of the Delegation of the Commission of the European Communities.

32ll. Motion for Resolution of the EEC dated October 27, 1983.

37. Continued

37h. Hearing before the Committee on Foreign Relations of the United States Senate on Six International Tax Treaties and Protocols, 96th Congress, 1st Sess. (June 6, 1979).

37i. Hearing before the Subcommittee on Taxation and Debt Management of the Congress on Finance on S.1113 and S.1974, 99th Congress, 2d Sess. (September 29, 1986).

46. Continued

46j. Letter from Michael Blumenthal, Secretary of Treasury to Martin Huff, Executive Officer California Franchise Tax Board, February 15, 1977.

46k. Letter from John S. Chapoton, Assistant Secretary Treasury (Tax Policy) to William J. Anderson, Director, General Government Division U.S., GAO Washington D.C., dated July 10, 1981.

46l. Letter from Donald Regan, Secretary of Treasury, to William Brock, United States Trade Representative, dated February 12, 1982.

46m. Letter from William Brock, United States Trade Representative to Donald Regan, Secretary of Treasury, dated February 22, 1982.

46n. Letter from Treasury Secretary James A. Baker III to House Ways and Means Committee Chairman, Dan Rostenkowski, dated March 5, 1986.

46o. Letter from Treasury Secretary James A. Baker III to Senate Finance Committee Chairman Bob Packwood, dated March 17, 1986.

46p. Letter from Treasury Secretary James A. Baker III to Speaker of the House of Representatives, Hon. Thomas P. O'Neill, Jr., dated December 18, 1985.

51. Continued

51x. BBI 1977 New York State Tax Return (Doc. No. 32678-3271).

53. The United Nations Model Double Taxation Convention Between Developed and Developing Countries, 1980.

54. United Kingdom Government Statement in Response to the Statement of the President dated November 8, 1985.

55. California Senate Bill 85 (Alquist) signed by Governor Deukmejian September 5, 1986, an act to add Chapter 1.9 (commencing with Section 15365), Chapter 6 (commencing with Section 15397) and Chapter 7 (commencing with Section 15398) to Part 6.7 of Division 3 of, and to add Article 12 (commencing with Section 16429.30) to Chapter 2 of Part 2 of Division 4 of, Title 2 of, the Government Code, to amend Sections 24274, 24344, 24348, 24667, and 24668 of, to amend and renumber Section 25110 of, to add Sections 24411 and 24670 to, and to add and repeal Article 1.5 (commencing with Section 25110) of Chapter 17 of Part 11 of Division 2 of, the Revenue and Taxation Code, relating to taxation.

56. United Kingdom Government Statement in Response to passage of Senate Bill 85, dated 5 September 1986.

57. Memo to File from Benjamin F. Miller regarding UDITPA Regulations 25137(m) and 25137(o) dated September 23, 1981 with attached Proposed Guidelines for the Preparation of Combined Reports which Include Foreign Country Operations.

58. Summary of Comments, Responses and Recommendations on Proposed Regulation 25137(m) Combined Reports Including Foreign Country Operation.

59. Summary of Comments Received Regarding FTB 1046 (12-79) and Department Responses.

60. US/USSR Treaty hearings and documents including letter from George Shultz to Nikolai Patolicher, Report of the Department of State, and the Report of the Senate Foreign Relations Committee.

This stipulation is made this 10th day of November, 1986.

JOANNE M. GARVEY
LAWRENCE W. JORDAN, JR.
JOAN K. IRION
JORDAN, KEELER & SELIGMAN

By _____
Joanne M. Garvey
Counsel for Plaintiffs

JOHN VAN DE KAMP, Attorney General of the State of California
EDWARD P. HOLLINGSHEAD, Supervising Deputy Attorney General

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Attorneys for Defendant

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SACRAMENTO

BARCLAYS BANK OF CALIFORNIA,
a California Corporation,
Plaintiff,

v.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

BARCLAYS BANK INTERNATIONAL, LIMITED,
a corporation of the Country of England,
Plaintiff,

v.

FRANCHISE TAX BOARD, an agency
of the State of California,
Defendant.

No. 325061
No. 325059

ENDORSED
Filed: December 20, 1985
Joyce Russell Smith, Clerk
By J.L. Holloway, Deputy

STIPULATION AND ORDER REGARDING
CLOSE OF DISCOVERY

IT IS HEREBY STIPULATED AND AGREED By Plaintiffs, Barclays Bank of California and Barclays Bank International Limited, and Defendant, The Franchise Tax Board, the parties hereto, by and through their respective counsel of record, that discovery for all matters shall close at the conclusion of business on February 14, 1986, which is ten days prior to trial.

DATED: December 10, 1985

JOHN K. VAN DE KAMP
Attorney General

EDWARD P. HOLLINGSHEAD
Supervising Deputy Attorney

By: _____
ROBERT D. MILAM
Deputy Attorney General

Attorneys for Defendant
Franchise Tax Board

DATED: December 10, 1985

JORDAN, KEELER &
SELIGMAN

By: _____
JOAN K. IRION

Attorneys for Plaintiffs
Barclays Bank of California and
Barclays Bank International
Limited

ORDER

IT IS SO ORDERED.

DATED: December 20, 1985

FRED W. MARLER JR. (CCP635)
Acting Presiding Judge
JUDGE OF THE SUPERIOR
COURT

APPENDIX D

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

UNITED STATES CONSTITUTION

Article I, Section 8, Clause 3 of the United States Constitution (the Commerce Clause) provides that:

> The Congress shall have power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Article VI, Clause 2 of the United States Constitution (the Supremacy Clause) provides that:

> The Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding.

CALIFORNIA REVENUE AND TAXATION CODE

§ 25101. Derivation from domestic and foreign sources; measure of tax; apportionment

When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of Article 2 (commencing with Section 25120). However, any method of apportionment shall take into account as income derived from or attributable to sources without the state, income derived from or attributable to transportation by sea or air without the state, whether or not the transportation is located in or subject to the jurisdiction of any other state, the United States or any foreign country.

If the Franchise Tax Board reapportions net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to it the basis upon which its reapportionment has been made.

APPENDIX E

RULE 29.1 LIST
BARCLAYS' LESS THAN 100% OWNED SUBSIDIARIES

Subsidiary	Ownership Interest
Europe Asia Dynamic Fund Management Co. SA	70.00%
Barclays Pizano Y Recoder	55.00%
Puget-Mahe SA	97.00%
Comigestion SA	97.00%
Puget-Mahe Contrepartie SA	97.00%
Massey-Ferguson Leasing Ltd.	75.00%
NB Geotech Finance Ltd.	51.00%
Fiatagri Finance Ltd.	51.00%
Barmac (Estates) Ltd.	50.10%
Blocksite Ltd.	50.20%
Bramingham Park Ltd.	50.10%
Chadacre Developments Ltd.	50.10%
Charmtape Ltd.	50.10%
Growlimit Ltd.	50.10%
J.V. Developments Ltd.	50.10%
Loopbeam Ltd.	50.10%
Mervest (Hendon) Ltd.	70.00%
Mervest (Sloane) Ltd.	51.00%
PSA Credit Company Ltd.	50.01%
Regmore Developments Ltd.	50.20%
Regmore Homes Ltd.	50.10%
Royco Business Parks Ltd.	50.10%
Wates-Barclays-Mercantile Homes Ltd.	50.01%
Wadham Stringer Credit Company Ltd.	75.00%
Barclays Motor Finance Ltd.	75.00%
Barclays Motor Wholesale Pty. Ltd.	75.00%
Barclays Bank of Botswana Ltd.	74.86%
Barclays Pensions Management Consultants (Pty.) Ltd.	74.86%
Barclays Bail SA	99.99%
Barclays Gestion SA	99.99%
Barclays Immobilier SARL	99.95%
Barclays Invest Ltd.	99.00%
Barclaymur SA	99.90%
Financiere Laffitte	99.99%
Laffitte Capital	99.99%
Laffitte Patrimoine	99.97%
Laffitte Gastion	99.80%
Laffitte Investissement	99.99%
Laffitte Securities SA	99.99%
S.A.G.O.	99.83%

Subsidiary	Ownership Interest
S.C. Des Garages du 21 Rue Laffitte	57.50%
Lutetia Societe Financiere SA	99.94%
Soc de credit Pour acquisition et amelioration des Immeubles	99.98%
S.F.G.C. (Group Barclays)	99.99%
Immogestion Barclays SA	95.04%
Society Civile Immobiliere Barclays IMMO-Hexagone	99.93%
Card Finanz Systeme AG	84.99%
Barclays Bank of Ghana Ltd.	60.00%
Barclays Bank of Ghana Forex Bureau Ltd.	60.00%
Barclays Bank of Kenya Ltd.	68.50%
Barclays Advisory and Services Ltd.	68.50%
Barclays (Kenya) Nominees Ltd.	68.50%
Barclays Merchant Finance Ltd.	68.50%
Spread Eagle Services Limited	66.51%
Barclays Bank of Serra Leone Ltd.	60.00%
Barclays Bank S.A.E.	89.43%
BARGES SA	88.23%
Ruval SA	89.43%
Segunda Banlid de Inversion Immobiliaria SA (SEBANSA)	89.42%
Barclays Leasing SA	89.42%
Barclays Entidad De Financiacion, SA	89.42%
Terbansa, SA	87.64%
Barclays Correduria de Seguros SA	98.00%
Barclays Bank of Swaziland Ltd.	60.00%
Barclays Bank of Uganda Ltd.	51.00%
Barclays Bank of Uganda (Foreign Exchange Bureau) Ltd.	51.00%
Barclays Bank of New York, NA[1]	99.90%
Societe d'Exploitation et de Gestion Immobiliere au Zaire	51.25%
AFCARME Zimbabwe Holdings (Pvt) Ltd.	70.00%
Barclays Bank of Zimbabwe Ltd.	70.00%
Barclays Vie S.A.	99.99%
Barclays Zimbabwe Nominees (Pvt) Ltd.	70.00%
Barclaytrust (Pvt) Ltd.	70.00%
Claydon Holdings, Inc.	95.00%
Claydon Properties, Inc.	95.00%

[1] Barclays Bank of New York, N.A. has a number of 100 percent owned subsidiaries, not listed here.

APPENDIX F

IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL LTD., et al.,
Plaintiffs and Respondents,
v.
FRANCHISE TAX BOARD
of the State of California,
Defendant and Appellant.

No. S019064
3 Civ. No. C003388
(Consolidated with 3 Civ. No. C003389)

After Decision by the Court of Appeal
Third Appellate District

Sacramento County Superior Court Nos. 325059 and 352061
The Honorable George E. Paras, Judge Pro Term

BRIEF AMICUS CURIAE OF THE UNITED STATES IN SUPPORT OF PLAINTIFFS AND RESPONDENTS

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United States Attorney

MAY 1991

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IN THE SUPREME COURT OF
THE STATE OF CALIFORNIA

BARCLAYS BANK INTERNATIONAL LTD., et al.,
Plaintiffs and Respondents,
v.
FRANCHISE TAX BOARD
of the State of California,
Defendant and Appellant.

No. S019064
3 Civ. No. C003388
(Consolidated with 3 Civ. No. C003389)

AMICUS CURIAE BRIEF OF THE UNITED STATES IN SUPPORT OF PLAINTIFFS AND RESPONDENTS BARCLAYS BANK INTERNATIONAL LTD., AND BARCLAYS BANK OF CALIFORNIA

ISSUE PRESENTED

Whether California's utilization of the worldwide unitary apportionment formula method of allocating income among multinational corporations engaged in foreign commerce in order to determine the taxable income of members of a foreign owned multinational group of corporations is unconstitutional in that it interferes with the Federal Government's conduct of foreign affairs in violation of the Foreign Commerce Clause.

INTEREST OF THE UNITED STATES

The power to regulate foreign commerce is reserved exclusively to the United States. Further, the Federal Executive has exclusive authority to conduct the foreign affairs of the United States, and pursuant to that authority can agree with foreign nations as to the norms and practices with respect to international commerce among nations. States may not engage in any practice which expressly conflicts with any act of the United States in these areas, or even implicates the United States' regulation of foreign commerce and conduct of foreign policy. In short the states may

not impair the right of the United States to speak with "one voice" in conducting and controlling foreign relations and international commerce.

This *amicus curiae* brief is submitted by the United States to protect that interest. It is the position of the United States that California's worldwide unitary income allocation method of taxation may not constitutionally be applied to the taxpayers (plaintiffs-respondents) without impairing the ability of the United States to speak with one voice in conducting and controlling foreign relations and international commerce.

STATEMENT

The instant case involves California's application of the worldwide unitary apportionment formula method of allocation of income to a unitary business group consisting of a foreign parent corporation and its subsidiaries. The California Franchise Tax Board interprets California law (Cal. Rev. & Tax. Code Secs. 230001 *et seq.*), and the regulations promulgated thereunder[1] to require that taxation of the income of corporations doing business in California, if the corporations are determined to be engaged in a "unitary" worldwide business enterprise, be measured by the worldwide income of the foreign parent and all of its subsidiaries, even those which are not domiciled and do no business in the United States. California first began to so measure income of unitary business groups in 1972. (CT. 1738.)[2]

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[1]California's statutes do not expressly provide for the allocation of income of related corporations on the basis of the worldwide unitary business concept method, but rather this method of allocation of income has been adopted by the California Franchise Tax Board in enforcing and administering California's corporate tax statutes. This method of taxation is designated as the "WWCR" (Worldwide Combined Reporting) method in the opinion of the Court of Appeal.

[2]"CT." references are to the record in the trial court as paginated by the clerk of the trial court which the parties have stipulated can be used as the record on this appeal.

a. *The implication of applying the worldwide unitary apportionment formula in the Federal Government's conduct of foreign policy.*

Income of multinational corporations has been identified and allocated to taxing jurisdictions by two different methods: (1) the worldwide combined reporting unitary method utilized by California and by several other states, and (2) the international standard, the separate accounting or "arm's length" adjustment method.[3] It is the expressed policy of the United States that the separate accounting or "arm's length" method is the appropriate method of allocating income among commonly controlled multinational corporations. (CT. 1740-1742.) This view has been adopted in the United States Internal Revenue Code (26 U.S.C., Section 482)[4] and is embodied in virtually all bilateral tax treaties that have been entered into by the United States. (CT. 1742.)[5] The

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[3]The transactional or geographical basis of taxation is commonly called the "arm's length" method of taxation because the taxpayer corporation is treated as a unit doing business with every other corporation and entity on an "arm's length" basis even though the other corporations are parents, subsidiaries or sister corporations. This method is designated as the "AL/SA" (Arms Length/Separate Accounting) method in the opinion of the Court of Appeal.

[4]Section 482 of the Internal Revenue Code was amended by Section 1231(e) of the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085, to provide that income from transfers of intangibles between related parties was to be "commensurate with the income attributable to the intangible." The Department of the Treasury and the Internal Revenue Service have advised the Department of Justice that their "study" or "White Paper" on transfer pricing concludes that this amendment is fully consistent with the arm's length standard. See, *A Study of Intercompany Pricing*, prepared jointly by Department of Treasury and the Internal Revenue Service, October 18, 1988.

[5]The United States has bilateral income tax treaties with 40 nations: Income Tax Treaty with Australia, May 14, 1953, T.I.A.S. No. 2880; Income Tax Treaty with Austria, October 25, 1956, T.I.A.S. No. 3923; Income Tax Treaty with Barbados, December 31, 1984, T.I.A.S. No. 11090; Income Tax Treaty with Belgium, July 9, 1970, T.I.A.S. No. 7463; Income Tax Treaty with Canada, August 16, 1984, T.I.A.S.

"arm's length" is the international norm. That standard has been

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No. 11087; Income Tax Treaty with Cyprus, March 19, 1984, T.I.A.S. No. 98-32; Income Tax Treaty with Denmark, May 6, 1948, T.I.A.S. No. 1854; Income Tax Treaty with Finland, December 30, 1990, S. Exec. Rept. No. 101-11; Income Tax Treaty with France, November 24, 1978, T.I.A.S. No. 9500; Income Tax Treaty with the Federal Republic of Germany, September 17, 1965, T.I.A.S. No. 5920; Income Tax Treaty with Greece, February 20, 1950, T.I.A.S. No. 2902; Income Tax Treaty with Hungary, February 12, 1979, T.I.A.S. No. 9560; Income Tax Treaty with Iceland, May 7, 1975, T.I.A.S. No. 8151; Income Tax Treaty with India, December 18, 1990, S. Exec. Rept. 101-5; Income Tax Treaty with Indonesia, December 30, 1990, S. Exec. Rept. 100-22; Income Tax Treaty with Ireland, September 13, 1949, T.I.A.S. No. 2356; Income Tax Treaty with Italy, April 17, 1984, T.I.A.S. No. 11064; Income Tax Treaty with Jamaica, May 21, 1980, T.I.A.S. No. 10207; Income Tax Treaty with Japan, March 8, 1971, T.I.A.S. No. 7365; Income Tax Treaty with Korea, June 4, 1976, T.I.A.S. No. 9506; Income Tax Treaty with Luxembourg, December 18, 1962, T.I.A.S. No. 5726; Income Tax Treaty with Malta, March 21, 1980, T.I.A.S. No. 10567; Income Tax Treaty with Morocco, August 1, 1977, T.I.A.S. No. 10195; Income Tax Treaty with the Netherlands, April 29, 1948, T.I.A.S. No. 1855; Income Tax Treaty with the Netherlands Antilles, October 23, 1963, T.I.A.S. No. 5665; Income Tax Treaty with New Zealand, November 2, 1983, T.I.A.S. No. 10772; Income Tax Treaty with Norway, December 3, 1971, T.I.A.S. No. 7474; Income Tax Treaty with Pakistan, July 1, 1957; T.I.A.S. No. 4232; Income Tax Treaty with People's Republic of China, October 22, 1986, S. Exec. Rept. 99-7 and S. Exec. Rept. No. 99-15; Income Tax Treaty with Poland, October 8, 1974; T.I.A.S. No. 8486; Income Tax Treaty with Republic of the Philippines, October 1, 1976; T.I.A.S. No. 10417; Income Tax Treaty with Romania, December 4, 1973, T.I.A.S. No. 8228; Income Tax Treaty with Spain, November 21, 1990, S. Exec. Rept. 101-16; Income Tax Treaty with Sweden, March 23, 1939, T.I.A.S. No. 958; Income Tax Treaty with Switzerland, May 24, 1951, T.I.A.S. No. 2316; Income Tax Treaty with Trinidad and Tobago, January 9, 1970, T.I.A.S. No. 7047; Income Tax Treaty with Tunisia, December 26, 1990, S. Exec. Rept. 99-13 and S. Exec. Rept. No. 101-9; Income Tax Treaty with the USSR, June 20, 1973, T.I.A.S. No. 8225; Income Tax Treaty with the United Arab Republic, August 24, 1980, T.I.A.S. No. 10149; Income Tax Treaty with the United Kingdom, December 31, 1975, T.I.A.S. No. 9682.

adopted by international organizations that have addressed transfer pricing issues including the United Nations and the Organization for Economic Cooperation and Development (OECD).[6] Virtually every major industrial nation relies on the arm's length standard in transfer pricing cases. (Letter at 1.)[7]

Application by states of the worldwide combined unitary method of taxation conflicts directly with this federal policy and international standard. The conflict between this state practice and federal policy is clearly articulated in the November 8, 1985, statement of President Reagan on this subject.[8] President Reagan's statement demonstrates the Federal Executive's determination that the state taxing practice in question should be curtailed either by the states themselves, by the judiciary or if necessary by

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In particular, Article 9(1) of the United States-United Kingdom convention provides:

> 1. Where an enterprise of a Contracting State is related to another enterprise and conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any income, deductions, receipts, or outgoings which would, but for those conditions, have been attributed to one of the enterprises but by reason of those conditions have not been so attributed, may be taken into account in computing the profits or losses of that enterprise and taxed accordingly.

[6]See Organization for Economic Co-operation and Development Committee on Fiscal Affairs, *Transfer Pricing and Multinational Enterprises* (1979); *United States Model Double Taxation Convention between Developed and Developing Countries,* Commentary to Article 5 (1980).

[7]A copy of the letter to Governor Deukmejian of California, dated January 30, 1986, from Secretary of State George P. Schultz is contained in Appendix A, *infra*. This letter was entered into evidence in this case by stipulation of the parties dated September 9, 1986. (Stip. 46(h).)

[8]A copy of the statement is attached hereto as Appendix B, *infra*, and has been entered into evidence in these cases by stipulation of the parties dated September 9, 1986. (Stip. 36(a).)

federal legislation. Further, in this statement the President instructed the Attorney General to ensure that this policy and the interest of the United States were represented in appropriate legal cases.

In letters dated January 30, 1986, to the governors of six states of the United States which employ the worldwide unitary method of taxation (Alaska, California, Idaho, Montana, New Hampshire and North Dakota) from the Secretary of State, George P. Schultz, the United States has informed the governors that the state's employment of worldwide unitary method of tax accounting is at odds with the position the United States has taken in the conduct of foreign affairs, and has become a source of conflict with foreign nations. (Letter.)

That the utilization of the unitary method of allocation of income interferes with the conduct of foreign policy is graphically demonstrated by the fact that the Ambassadors of Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands and Switzerland in a diplomatic note have advised the United States that the unitary method of taxation constitutes "a serious obstacle to the further development of our trade and investment relationships." (Letter at 2.) In addition, the Parliament of the United Kingdom in July, 1985, adopted legislation providing for retaliation against United States corporations which operate in the worldwide unitary tax states. This legislation denies parent corporations doing business in states which employ the unitary tax method tax credits on the taxes they pay to the United Kingdom on account of dividends paid in England by their subsidiaries and imposes substantial penalties on them.[9] These credits reflect the income taxes the United Kingdom subsidiaries pay with respect to the income they distributed

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[9]United Kingdom Finance Bill, Clause 27, adopted by the House of Commons July 10, 1985, House of Commons Official Report. Parliamentary Debates (Hansard) 1014-18 (10 July 1985). See also Letter at 3. That legislation contains a provision making possible the retroactive imposition of heavy penalties.

as dividends. These credits are provided for under the United States-United Kingdom bilateral income tax convention. The United Kingdom has not yet invoked this legislation, but its enactment is a clear indication of the adverse impact of the unitary method of taxation on the conduct of foreign economic relations by the United States. The filing of an *amicus curiae* brief in these cases in the courts below on behalf of the United Kingdom and the arguments against the unitary tax method made in those briefs are additional evidence of the negative impact of the California unitary tax system on the conduct of foreign policy by the United States.

b. *The application of the worldwide unitary apportionment formula to the taxpayers in these consolidated cases.*

The plaintiffs involved herein are Barclays Bank International, Limited (BBI) and Barclays Bank of California (Barcal). During the tax year in question (1977) BBI, a corporation organized under the laws of the United Kingdom, operated an international banking business in a number of countries including the United States (Appellant Br. 3.)[10] BBI was during the period in issue a wholly owned subsidiary of Barclays Bank Limited, also a corporation organized under the laws of the United Kingdom. *(Ibid.)*[11] BBI operated directly in California and as such was subject to regulation by the State of California. Barcal was a California banking corporation, a wholly-owned subsidiary of BBI during the tax years at issue, doing a general retail banking business only in California. *(Ibid.)* As plaintiffs were doing business in California they were subject to taxation by the United States and the State of California.

For the tax year 1977 Barcal filed a tax return with the Franchise Tax Board which reported all the income it earned

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[10]"Appellant Br." references are to pages in Appellant's Opening Brief on this appeal.

[11]In 1985 BBI and Barclays Bank Limited merged under the laws of the United Kingdom to form Barclays Bank PLC.

which was only from California sources and thus fully taxable by California. This return was based upon the separate accounting method and hence none of its income was apportioned. BBI filed a return for the year 1977 with the Franchise Tax Board which reported not only the income BBI earned from California sources but also included: (1) income BBI earned from operating bank agencies and branches in the United Kingdom and approximately 33 nations or territories outside of the United Kingdom, including California; and (2) the income earned by 70 subsidiaries of BBI which operated in 34 nations or territories outside of the United Kingdom. (Appellant Br. 3.) BBI's California tax return was based upon the worldwide combined reporting method, and the income reported thereon was apportioned to California using the three-factor formula method as applicable to banks. (Appellant Br. 3.)

The California Franchise Tax Board upon audit of these returns determined that Barcal and BBI were members of a worldwide unitary business conducted by all members of the Barclay Group which included: (1) Barcal, a wholly-owned subsidiary of BBI doing business only in California; (2) BBI, a United Kingdom Corporation doing general retail and commercial banking in the United Kingdom and 34 other nations or territories outside the United Kingdom, including California; (3) the subsidiaries of BBI in which BBI has more than a 50% interest; (4) Barclays Bank Limited, a United Kingdom corporation which conducts no business in California and which owns 100 % of the stock of BBI; and (5) the subsidiaries of Barclays Bank Limited in which that corporation holds more than a 50% interest. (Appellant Br. 3-4.) The California Franchise Tax Board then calculated BBI's and Barcal's tax by allocating a portion of the total income of the above unitary group to these two taxpayers utilizing a three-factor apportionment formula.

Under the three-factor apportionment formula, the in-state corporation's income is calculated as a percentage of the total income of the group of related corporations. After the unitary business group is identified, the in-state corporation's sales, property, and payroll are expressed as a fraction of the total sales, property, and payroll of the unitary group; these three fractions

are arithmetically averaged, and this average when multiplied against worldwide group income, yields the taxable income of the in-state corporation. Thus, the apportionment to the in-state corporation of a percentage of the total income of the unitary group is a mathematical function of the income of the total unitary business group, including those members of the unitary business group operating outside the taxing state.

Utilizing the above method of taxation, proposed tax assessments were issued. (Appellant Br. 5.) The taxpayers claimed this taxation to be improper as it was based not only on their income but also on the income of their foreign parent and upon the income of other foreign subsidiaries of their parent who do not do business in California or elsewhere in the United States. These taxpayers protested the proposed assessments to the Franchise Tax Board, and thereafter paid the proposed tax assessments and sued for a refund of these taxes in the California Superior Court for Sacramento County. (Appellant Br. 5.) One of the grounds raised by the taxpayers in these refund suits was that the Foreign Commerce Clause of the United States Constitution prohibited the application of the worldwide unitary business three-factor formula method for computing the income of the taxpayers. (Appellant Br. 7.)

The trial court entered a judgment and opinion in favor of the taxpayers on August 20, 1987. (CT. 1687, 1716.) This decision rested upon the trial court's conclusion that California's computation of the taxes in question using the worldwide combined unitary business group reporting and three-factor method of apportioning the business group's income to California sources was impermissible as it discriminated against foreign commerce (CT. 1751), violated due process (CT. 1755, 1756) and because it contravened the Foreign Commerce Clause of the United States Constitution as it impeded the Federal Government's ability to speak with one voice in the conduct of foreign affairs, an area wherein federal uniformity is necessary (CT. 1738, 1746, 1747, 1749, 1758-1760).

Thereafter the Franchise Tax Board appealed to the Court of Appeal of California in and for the Third Appellate District and that Court on November 30, 1990, affirmed the decision of the

trial court. 255 Cal.App.3d 1342. That court held (1) there was no affirmative federal policy permitting California's use of "worldwide combined reporting" and therefore a dormant Foreign Commerce Clause analysis was in order (Slip Opinion, pp. 23-30); (2) California's use of "worldwide combined reporting" implicated foreign policy issues which must be left to the federal government (Slip Opinion, pp. 31-41); and (3) California's use of "worldwide combined reporting" frustrated the United States' ability to speak one voice in an area of foreign affairs wherein federal uniformity was necessary, and therefore it violated the Foreign Commerce Clause. (Slip Opinion, pp. 41-52.) The Court of Appeal denied the Franchise Tax Board's timely petition for rehearing, and on February 28, 1991, this Court granted the Franchise Tax Board's petition for review.

The instant *amicus curiae* brief supports the trial court's and the Court of Appeal's conclusion that California's application of its worldwide unitary business concept and apportionment formula method of allocating income among a unitary business group controlled by a foreign parent corporation is unconstitutional under the Foreign Commerce Clause as it impairs the ability of the United States to speak with one voice in an area of foreign affairs wherein federal uniformity is necessary.

SUMMARY OF ARGUMENT

BBI, a British corporation, and its subsidiary, Barcal, a California corporation, are engaged in the banking business in California. BBI is the wholly owned subsidiary of Barclays Bank Limited, a British corporation. The California Franchise Tax Board determined that BBI and Barcal were part of a worldwide unitary business and determined their income for 1977 under the worldwide unitary method of taxation. Under that method, the income of all companies that were engaged in a unitary business, including the British parent of BBI and that parent's 50 percent owned subsidiaries that did no business in California, were combined, after eliminating intercompany transactions, to determine the net income of the unitary business. This net income was then apportioned to California on the ratio of the unitary business' California property, payroll and sales to the unitary business' total property,

payroll and sales. The issue presented in this case is whether California's unitary taxation method as applied in determining the tax liability of a foreign corporation and its subsidiary that do business in California represents an unconstitutional burden upon, and interference with, foreign commerce. The Superior Court and the Court of Appeal held, *inter alia*, that the unitary taxation method as applied in the instant cases was unconstitutional because the tax constitutes an impermissible interference in the conduct of the nation's foreign affairs. We agree and submit that that reason alone warrants affirmation of the judgment of the Court of Appeal below.

Under the Commerce Clause of the United States, a state may not, when imposing an income-based tax, tax value outside its border. The state may, however, constitutionally tax on an apportioned basis the total income and property of a corporation earning income in, and moving its property through, multiple taxing jurisdictions. The test for constitutionality of a tax imposed on an apportioned basis under the dormant interstate commerce clause is: (1) there must be a substantial nexus between the state and the activity or property taxed; (2) the activity or property must be fairly apportioned to the taxing state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. When, however, the state tax is challenged under the dormant Foreign Commerce Clause, two additional questions must be addressed to determine the constitutionality of the tax: (1) whether the tax creates a substantial risk of international multiple taxation, and (2) whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. Because the tax in question fails under the second test, it is unnecessary to address any other tests.

The Federal Constitution has conferred upon the Federal Government the exclusive power to represent this nation in matters of foreign affairs. The United States and its foreign trading partners have consistently used the "arm's length" standard in allocating income between nations. Although the Court, in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), upheld the constitutionality of California's

worldwide unitary method of income taxation as applied to a domestic parent corporation with foreign subsidiaries, the Court reserved judgment as to whether the constitutionality of the tax would be upheld as applied to a foreign controlled corporate group, the issue presented in these cases. Unlike the *Container Corporation* case, the Federal Government has participated in this case to demonstrate that the application of the apportionment method used by California in these cases implicates foreign policy issues and prevents the Federal Government from speaking with one voice in this very sensitive area of foreign policy. Not only has the United States indicated to other nations the standard that should be used in apportioning income and not only have its foreign trading partners agreed to this standard, but its trading partners expect all political units of the United States to abide by this standard. Its major trading partners have protested the use of the unitary method of taxation to allocate income. California's insistence upon the use of that method has seriously complicated the Federal Government's economic relations with its major trading partners. In addition, the United Kingdom has enacted retaliatory legislation. The Court in *Container Corporation* opined that the most obvious foreign policy implications of a state tax is the retaliation by foreign governments against the United States. The *Container Corporation* court further noted that the nuances of foreign policy were much more the province of the Federal Executive than the Courts and that deference was due to its views. Neither retaliatory legislation nor the Federal Executive's views were presented in that case. There can be little doubt that the apportionment method used by California in the instant case is an impediment to the Federal Government's conduct of foreign relations and is thus unconstitutional.

The Appellant argues that the dormant Foreign Commerce Clause analysis, upon which the Federal Government, the Superior Court and the Court of Appeal have relied, is irrelevant because under the principles enunciated in *Wardair Canada v. Fla. Dept. of Revenue*, 477 U.S. 1 (1986), affirmative Congressional action has by implication allowed the states great freedom in the manner in which they impose income taxes including the freedom to employ the apportionment method in issue. In support of that position, the Appellant points to the fact that the Federal

Government's tax policy with its trading partners in treaties or otherwise has dealt generally with federal taxation and that the Senate explicitly refused to approve the United States-United Kingdom Tax Convention until the clause barring the use of the worldwide apportionment method was removed from the treaty. We are unaware that either the Congress or the Executive has ever given even tacit approval to the use of that method. Indeed, even with respect to the exclusion of the clause in the United States-United Kingdom Tax Convention forbidding this method of tax apportionment, the majority of the Senate favored eliminating that method. Thus, there is hardly any federal policy that eliminates the necessity of resorting to the dormant Foreign Commerce Clause analysis to test the Constitutionality of the apportionment method in issue.

We submit that for the reasons stated above, the judgment of the Court of Appeal should be affirmed.

ARGUMENT

THE COURT OF APPEAL CORRECTLY HELD THAT THE TAX IMPOSED ON THE TAXPAYERS IN THESE CASES WAS UNCONSTITUTIONAL BECAUSE ITS APPLICATION IMPLICATED UNITED STATES FOREIGN POLICY BY PREVENTING THE UNITED STATES FROM SPEAKING WITH ONE VOICE IN CARRYING OUT ITS COMMERCIAL RELATIONS WITH FOREIGN GOVERNMENTS

A. *Controlling legal principles.*

The power to regulate foreign commerce is reserved exclusively to the United States by the Foreign Commerce Clause of Article I, Section 8, Clause 3 of the United States Constitution. Further, it has been unequivocally established that the Federal Government, primarily through the Executive Branch, possesses the sole and exclusive authority to conduct and control the foreign affairs of the United States. *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp.*, 333 U.S. 103, 111 (1948); *United States v. Pink*, 315 U.S. 203 (1942); *United States v. Belmont*,

301 U.S. 324 (1937); *United States v. Curtiss-Wright Export Corp.*, 299 U.S. 304, 314-316 (1936); *Oetjen v. Central Leather Co.*, 246 U.S. 297 (1918).

Under the Commerce and Due Process Clauses of the United States Constitution, a state may not impose a property or income tax on tax values situated or earned outside its borders. *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 164 (1983), rehearing denied 464 909 (1983); *Asarco, Inc. v. Idaho State Tax Commission,* 458 U.S. 307, 315 (1982). However, within the ambit of interstate commerce it has been recognized that a state may constitutionally tax on an apportioned basis the total income and property of a corporation earning income in, and moving its property through, multiple taxing jurisdictions. *Container Corp. v. Franchise Tax Board, supra* at 164; *Exxon Corp. v. Department of Revenue of Wisconsin,* 447 U.S. 207 (1980); *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 444-445 (1979); *Mobil Oil Corp. v. Commissioner of Taxes of Vermont,* 445 U.S. 425 (1980); *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450, 460 (1959). The test for constitutionality of a tax imposed on such an apportionment basis on property or income of a corporation engaged in interstate commerce is: (1) there must be a substantial nexus between the state and the activity or property taxed; (2) the activity or property must be fairly apportioned to the taxing state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to the services provided by the state. *Wardair Canada, Inc. v. Florida Dept. of Revenue,* 477 U.S. 1, 8 (1986); *Japan Line, Ltd., supra* at 444-445; *Container Corp., supra* at 164.[12] *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977).

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[12]The linchpin of apportionment in the field of state income taxation is the unitary business principle. *Mobil Oil Corp., supra.* The constitutional requirements set forth above as they pertain to the unitary business/formula apportionment method of taxation require that a state not tax a unitary business unless some part of it is conducted within the state, unless there is some minimal connection between interstate

If the unitary business groups involved herein were only doing business in interstate commerce, the application of the unitary business concept and the apportionment formula method of taxation would not be unconstitutional. However, the plaintiffs are corporations which are members of a group controlled by a foreign parent corporation engaged in international commerce, and the above analysis of the Commerce Clause as it relates to interstate commerce is not identical to the analysis of that clause as it relates to foreign commerce. *Japan Line, Ltd., supra* at 446. The Commerce Clause as it relates to foreign commerce unequivocally reserves to the Federal Government exclusive power and jurisdiction to control and regulate foreign commerce. *Brolan v. United States*, 236 U.S. 216, 218-219 (1915). The Supreme Court in *Michelin Tire Corp. v. Wages, Tax Commissioner*, 423 U.S. 276, 285 (1976), clearly stated that state taxation cannot so impinge upon foreign policy considerations so as to prevent the United States from speaking with one voice when regulating commercial relations with foreign governments. The Supreme

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activities and the taxing state, and unless there is a rational relationship between the income attributable to the in-state corporation and intrastate values of the unitary enterprise. *Container Corp., supra* at 166; *Exxon Corp., supra* at 220; *Mobil Oil Corp., supra* at 436, 437; *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940). The second requirement above that the income or tax be fairly apportioned has two components: first, fairness requires internal consistency, so that if every state employs the formula the result would be that no more than all the income of the unitary business would be taxed; and secondly, there must be external consistency such that the factors used in the apportionment formula reflect a reasonable sense of how the income is generated. *Container Corp.*, 463 U.S. at 169. These constitutional considerations also require that there be some bond of ownership or control uniting the purported unitary business. *Asarco, Inc., supra* at 316-317. In addition, the above principles have required that the out-of-state activities be related in some concrete way to the in-state activities; *i.e.*, that there be some sharing or exchange of value not capable of precise identification or measurement beyond the mere flow of funds arising out of passive investment. *Asarco, Inc., supra* at 317; *Mobil Oil Corp., supra* at 438-432. However, these requirements are not addressed in this brief.

Court in *Japan Line, Ltd., supra* at 446-448, stated that when foreign commerce is present in a situation involving a state tax on an instrument of foreign commerce, two additional requirements are necessary for constitutionality: first, there must be no enhanced risk of multiple taxation; and second, the tax on the instrumentality of foreign commerce may not impair federal uniformity of policy where uniformity is essential. The focus of the second requirement is that the tax cannot prevent the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. at 8; *Container Corporation of America v. Franchise Tax Board*, 463 U.S. at 185-197. The Court in *Japan Line, Ltd.*, 441 U.S. at 451, stated that "[i]f a state tax contravenes either of those precepts, it is unconstitutional under the Commerce Clause."

Three recent Supreme Court decisions inform analysis for the resolution of the instant appeals. The first is *Japan Line, Ltd. v. County of Los Angeles, supra*. In that case, California imposed a nondiscriminatory, apportioned, ad valorem property tax on cargo containers that were instrumentalities of foreign commerce temporarily located in California ports. The containers were subjected to an unapportioned property tax in their country of domicile, Japan. The Court determined that the tax there in issue was unconstitutional because it resulted in multiple taxation of instrumentalities of foreign commerce and prevented the United States from speaking with one voice in the conduct of foreign affairs. 441 U.S. at 451-454.

With respect to the requirement that the taxation method used must not enhance the risk of multiple taxation, the Supreme Court in *Japan Line, Ltd., supra* at 446, 447, postulated certain preliminary principles. Multiple and duplicative taxation is offensive to the Commerce Clause. In order to prevent multiple and duplicative taxation states are required to impose taxes on instruments of domestic interstate commerce on an apportioned basis so that an instrumentality is subject to no more than one tax on the full value being taxed. In the interstate arena, the Court is able to enforce fair apportionment by all potential taxing jurisdictions in the United States. The Supreme Court stated that when

foreign commerce is implicated in the imposition of an apportioned state tax (441 U.S. at 447-448 footnote omitted) —

> * * * neither this Court nor this Nation can ensure full apportionment when one of the taxing entities is a foreign sovereign. If an instrumentality of commerce is domiciled abroad, the country of domicile may have the right, consistently with the custom of nations, to impose a tax on its full value. If a State should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results. Hence, whereas the fact of apportionment in interstate commerce means that "multiple burdens logically cannot occur," *Washington Revenue Dept.*, 435 U.S. at 746-747, the same conclusion, as to foreign commerce, logically cannot be drawn. Due to the absence of an authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value, a state tax, even though "fairly apportioned" to reflect an instrumentality's presence within the State, may subject foreign commerce " 'to the risk of a double tax burden to which [domestic] commerce is not exposed, and which the commerce clause forbids.' " *Evco v. Jones*, 409 U.S. at 94, quoting *J.D. Adams Mfg. Co.*, 304 U.S. at 311.

With respect to the second requirement that a state tax may not impair federal uniformity of policy were uniformity is essential, the Court in the *Japan Line, Ltd.* case stated (441 U.S. at 448) that:

> Second, a state tax on the instrumentalities of foreign commerce may [not] impair federal uniformity in an area where federal uniformity is essential. Foreign commerce is preeminently a matter of national concern. "In international relations with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933).

The second case is *Container Corp. of America v. Franchise Tax Board, supra,* in which the Court analyzed the constitutionality of California's use of the worldwide unitary method of taxation

in taxing the income of a domestic corporation, which, with its subsidiaries, did business in the United States and in foreign countries. The Court therein first analyzed the tax in question pursuant to the requirements for constitutionality of a corporate group engaged only in domestic interstate commerce, and found California's tax to be constitutionally permissible under those standards. *Container Corp., supra* at 185. Since the unitary group of corporations was doing business in foreign nations as well as in California, the Court found it necessary to examine the constitutionality of the tax in question under the two additional tests formulated in *Japan Line* for testing the constitutionality of a state tax on an instrument or entity engaged in foreign commerce, *i.e.*, whether the tax involved an enhanced risk of double taxation, and whether the tax impaired the United States' ability to speak with one voice in an area of foreign commercial relationships where federal uniformity is necessary.

With respect to the first requirement posited in *Japan Line* under the dormant Foreign Commerce Clause, the Supreme Court in *Container Corp.* found that application of the unitary apportionment formula in taxing the income of the subsidiary of a domestic parent with foreign subsidiaries did not entail an enhanced risk of double taxation. The Court in *Container Corp.* concluded on the evidence before it that the "arm's length" method of taxation also entailed risks of double taxation in the field of foreign commerce; and since risks of double taxation were unavoidable under both alternatives, and could only be avoided by the state not taxing the group's income at all (which was unacceptable since some of the group's income was sourced in the state), application of the unitary business concept and apportionment formula was not unconstitutional by virtue of the unavoidable possibilities of double taxation. *Container Corp., supra* at 189-193. The courts below on the basis of this reasoning in *Container Corp.*, found that there was no enhanced risk of double taxation

with respect to the tax imposed herein. (Slip Opinion, pp. 30-31; CT. 1750.)[13]

Next the Supreme Court in *Container Corp.* elaborated at length on the second requirement it established in *Japan Line,* to determine the constitutionality of a state tax applied to an instrumentality of foreign commerce. The Court stated (463 U.S. at 186, 194 (footnote omitted)):

> "A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the State imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. . . . . If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign Commerce." [quoting *Japan Line, Ltd., supra* at 448.)
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> In conducting this inquiry, however, we must keep in mind that if a state tax merely has foreign resonances, but does not implicate foreign affairs, we cannot infer "[a]bsent some explicit directive from Congress, . . . that treatment of foreign income at the federal level mandates identical treatment

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[13]We do not address this conclusion of the courts below. This brief emphasizes the invalidity of the application of the tax in question because the tax prevents the Federal Government from speaking with one voice in the conduct of foreign affairs and international trade. This emphasis on the second requirement in *Container Corp.* is not a concession that California's tax does not enhance the risk of double taxation, but rather is a recognition that this tax is an egregious interference with the Federal Executive's conduct of foreign affairs and is thus, patently unconstitutional.

by the States." *Mobil,* 445 U.S. at 448. See also *Japan Line,* 441 U.S. at 456, n.20; *Michelin Tire Corp., supra,* at 286. Thus, a state tax at variance with federal policy will violate the "one voice" standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive. The second of these considerations is, of course, essentially a species of preemption analysis.

Next the Supreme Court stated (463 U.S. at 194, 195-196):

> The most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole. 441 U.S. at 450. In considering this issue, however, we are faced with a distinct problem. This Court has little competence in determining precisely when foreign nations will be offended by particular acts, and even less competence in deciding how to balance a particular risk of retaliation against the sovereign right of the United States as a whole to let the States tax as they please.
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> A state tax may, of course, have foreign policy implications other than a threat of retaliation. We note, however, that in this case, unlike *Japan Line*, the Executive Branch has decided not to file an *amicus curiae* brief in opposition to the state tax. The lack of such a submission is by no means dispositive. Nevertheless, when combined with all the other considerations we have discussed, it does suggest that the foreign policy of the United States — whose nuances we must emphasize again, are much more the province of the Executive Branch and Congress than of this Court — is not seriously threatened by California's decision to apply the unitary business concept and formula apportionment in calculating appellant's taxable income.

Having found this tax as applied in *Container Corp.* not to enhance the risk of double taxation, and further not to implicate foreign policy issues, the Supreme Court upheld the tax in question. However, the Supreme Court in *Container Corp.* ex-

pressly reserved judgment as to whether the constitutionality of the tax would be upheld as applied to a foreign controlled corporate group, the issue presented in this case. *Container Corp., supra* at 189, n.26, and 195 n.32.

The third case germane to the instant controversy is *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986). In that case the State of Florida's sales taxation of all fuel purchased in Florida was challenged by a Canadian airline operating charter flights to and from the United States. The airline attacked the validity of Florida's tax statute insofar as it authorized assessment of a tax on fuel used by foreign airlines engaged exclusively in foreign commerce. The airline argued: that by the Federal Aviation Act Congress preempted the field of foreign air travel and thus left no room for local government taxation of such travel; that the tax violated the Foreign Commerce Clause of the United States Constitution and a federal policy expressed in the Convention on International Civil Aviation of 1944 (Chicago Convention) to which Canada, the United States, and 155 other nations were parties; and that the tax was inconsistent with the Nonscheduled Air Services Agreement between the United States and Canada regulating air charter service between the United States and Canada.

The Supreme Court in *Wardair* first analyzed the preemption argument and noted that Congress through the Federal Aviation Act had regulated aviation extensively. But the Supreme Court held that state law is not automatically preempted wherever there is a federal regulation of an activity, an industry or an area of the law. The Court noted that when Congress legislates within the scope of its constitutionally granted powers, that legislation may displace state law. Whether or not there is such a preemption depends upon whether Congress intended to displace state law. If there is an actual conflict between state law and federal law then it is presumed that Congress intended preemption. Where there is no actual conflict between federal and state law, the Supreme Court has required evidence of a congressional intent to preempt the field. *Wardair Canada, Inc., supra* at 6. In *Wardair* the Supreme Court found that not only was there a lack of evidence of an intent to preempt the field but to the contrary, the Federal

Aviation Act expressly permitted state sales taxation of purchases of airline fuel. Thus, there was no preemption in the carrier's favor. (477 U.S. at 7.)

With respect to the Foreign Commerce Clause argument, the Supreme Court likewise held the state tax valid. The Supreme Court first recognized that in cases where the Federal Government had not acted, it is the responsibility of the judiciary to strike down action taken by state or local authorities that unduly threatens the values protected by the Commerce Clause. *(Ibid.)* The parties in *Wardair* claimed the tax in question impaired the ability of the United States to speak with one voice in the field of foreign relations.

The Court in *Wardair* noted a special need in the area of foreign commerce for federal uniformity, citing *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933), and *Japan Line, Ltd. v. County of Los Angeles, supra*. The Court stated that "In international relations and with respect to foreign intercourse and trade the people of the United States act through a single government with unified and adequate national power." *Wardair Canada, Inc., supra* at 8. The Supreme Court in *Wardair* then reiterated the two additional requirements for testing the validity of a state tax affecting foreign commerce as posited in *Japan Line, Ltd.* to wit: whether the state tax enhances the risk of international multiple taxation; and whether the tax impairs the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. (477 U.S. at 8.) In *Wardair* it was admitted that there was no threat of multiple taxation as the Florida tax was imposed solely upon the sale within the state of airline fuel. Rather the carriers contended that the tax was invalid because there existed a federal policy of reciprocal tax exemptions for the instrumentalities of international air traffic, including aviation fuel, and that this policy represents the statement that the "one voice" of the Federal Government wished to make, and this "one voice" statement was threatened by the state tax in question (*Id.* at 9.)

The Supreme Court in *Wardair* held that the various conventions and agreements cited by the parties did not evidence any such federal policy as contended by the parties but rather showed

that the Federal Government had accepted and allowed state taxation of fuel purchased within the taxing states' borders. Further, the affirmative action by the Federal Government in these conventions and agreements in allowing such state taxation removed this case from the context of a dormant Foreign Commerce Clause situation in which the Federal Government had remained silent and had allowed the states to act in this area without any need for uniformity. (*Id.* at 9.) In short, rather than preempting the field in favor of the carrier, the Congress by affirmatively allowing state taxation of aviation fuel in the Chicago Convention and in the more than 70 bilateral agreements governing international aviation to which the United States was a party, had affirmatively decided to permit such state taxation. The Supreme Court in *Wardair* concluded that there was no silence on the issue which would trigger a dormant Foreign Commerce Clause analysis and there was no announced federal policy on the issue which the Florida tax contravened. Accordingly, the Florida sales tax on aviation fuel as levied on foreign aviation carriers was upheld by the Supreme court in *Wardair*.

It is submitted that under the foregoing rationales of the Supreme Court's decisions in *Japan Line, Ltd., Container Corp.*, and *Wardair*, California's application of its worldwide unitary apportionment formula method of computing income tax is unconstitutional as applied to a unitary group of corporations controlled by a foreign parent corporation. Such an application impairs the ability of the United States to speak with one voice in the conduct of foreign commercial relations in an area where federal uniformity is necessary. Application of this tax has disrupted the foreign relations of the United States as conducted by the Federal Executive and has given rise to retaliatory legislation by one foreign nation.

B. *Under the controlling constitutional principles the instant tax as applied to the taxpayers is unconstitutional.*

The Federal Government is responsible for the formulation and implementation of the foreign policy of the United States. State statutes or practices conflicting with or impeding the Federal

Government's responsibilities with respect to the foreign relations of the United States are void under the Federal Constitution.

The trial and appellate courts below, citing *Container Corp.* concluded that Congress had not enacted any statute either favoring or opposing income taxation by states of foreign nationals through application of the worldwide unitary business concept and three-factor apportionment formula. (Slip Opinion, pp. 17, 21-30; CT. 1740, 1758.)[14] Thus the courts below properly found that there was no direct conflict between the state tax as applied and any federal statute or Congressional policy, hence there was no issue of preemption. (Slip Opinion, pp. 17, 21-30; CT. 1745.) Accordingly, the courts below proceeded to apply a dormant Foreign Commerce Clause Analysis to the facts of this case.

The Court of Appeal and the trial court correctly found the Federal Executive to have taken the position that California's method of computing the income tax of a member of a unitary business group owned by a foreign parent corporation should be

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[14]The Court of Appeal and the trial court noted that the Federal Executive had negotiated in the 1975 United States-United Kingdom Tax Treaty a clause (Clause 9(4)) proscribing a state's use of the worldwide unitary business concept and three-factor formula in computing a foreign corporation income tax; and that this clause was inserted at the instance of the United Kingdom as a result of California's extension of the said method of income tax computation to foreign nationals. The Senate Foreign Relations Committee defeated in committee a reservation with respect to Clause 9(4) by a vote of 10 to 5. On the Senate floor the reservation was again defeated by a vote of 46 to 34; thereafter the treaty received a favorable vote of 49 to 32, five votes short of the ⅔ vote required for advice and consent to ratification. Subsequently Clause 9(4) was reserved to without a vote and the treaty was approved with the reservation. The courts below held that these three votes favoring Clause 9(4) (one in committee and two on the Senate floor) did not evidence a Congressional policy for California's method of taxation but rather, if anything, a Congressional preference, not amounting to a policy, favoring discontinuance of California's method of taxation. (Slip Opinion, pp. 28-29; CT. 1739-1740.)

discontinued as contrary to internationally accepted accounting standards (Slip Opinion, pp. 34, 45, 52; CT. 1741) and the international practice favoring the arm's length method of tax computation (Slip Opinion, p. 54; CT. 1749). The application of California's method of taxation in computing the tax of the taxpayers involved in this case is unconstitutional under the Foreign Commerce Clause as an impermissible interference with the Federal Government's policy and conduct of foreign relations.

The adoption by the Federal Executive of this policy is evidenced by the letter of January 30, 1986, from the Secretary of State for the United States to the Governor of California, wherein the Federal Executive advises that in the conduct of foreign affairs it has taken "the position that the 'arm's length' adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed." (Letter.) The letter further states that this view is reflected in the bilateral tax treaties to which the United States is a party. Those tax treaties provide that income attributable to "permanent establishment" in the territory of a party will be taxed by that party on the basis of the arm's length method of apportionment. (See footnote 5, *supra*.)[15] The Internal Revenue Code also adopts this apportionment method. Moreover, this letter from the Secretary of State clearly expresses the position taken by the Federal Executive that the arm's length apportionment method is the "international standard" and "international rule" which has been adopted generally by foreign tax systems, and is prescribed in the model income tax treaties published by the Organization for Economic Cooperation and

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[15]Contrary to the Appellant's argument (Br. 32, n.23), there is nothing in the recent treaties departing from the arm's length method. Indeed, Article 9(3) of the Income Tax Treaty with Barbados, December 31, 1984, T.I.S.A. No. 11090, was added to make it clear that the United States retained the right to apply its inter-company pricing rules, which apply the arm's length standard. (Code Sec. 482 (of the arm's length standard)). S. Exec. Rept. 99-9, 99th Cong. 1st Sess. at 25.

Development (OECD) and the United Nations. (Letter.) Article II of the Constitution vests the power to conduct and control the foreign affairs of the United States solely with the President of the United States and his duly appointed aides; and the Executive has the particular expertise needed to identify and assess which rules and practices are generally accepted and followed by the international community and which are not. Its determinations in such regard are entitled to very great weight by the courts. *Container Corp.*, 463 U.S. at 195. See also *Factor v. Laubenheimer*, 290 U.S. 276, 295 (1933); *Charlton v. Kelley*, 229 U.S. 447, 468 (1913).

It is the position of the United States Government, as reflected in the letter of the Secretary of State to the Governor of California, that the unitary tax is at odds with the "arm's length" accounting method which is the international rule and standard, and that adherence to the "arm's length" method of taxing corporations with foreign parents is essential to avoid adverse consequences for the foreign relations of the United States. (Letter.) Under these circumstances, state tax methods which contravene this position cannot be reconciled with the Foreign Commerce Clause of the United States Constitution. The conflict between this position adopted by the United States in the conduct of foreign relations and the California tax as applied in the instant case to taxpayers with foreign parents must, therefore, be resolved in favor of the position taken by the United States.

This conflict is precisely the type of state action which the Supreme Court in *Container Corp., supra*, found would be unconstitutional in that it prevents the Federal Government from speaking with one voice in foreign relations. Moreover, this conflict is substantial in nature, as is evidenced by the Secretary of State's letter to the Governor of California to the effect that state worldwide unitary taxes have become a source of conflict with numerous foreign governments, including those of Australia, Belgium, Canada, Denmark, France, the Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands and Switzerland. (Letter.) The

Secretary of State concluded in his letter to Governor Deukmejian (Letter at 2) that:

> Continued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation. The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies.

Further, the conflict has resulted in the United Kingdom's enactment of retaliatory legislation. (Letter.) The Supreme Court in *Container Corp.* pointed out 463 U.S. at 194, that the most obvious interference with foreign affairs which a state tax statute could pose was offending foreign trading partners to such an extent that they might enact retaliatory legislation against the United States as a whole, but that there was no such retaliatory legislation demonstrated in *Container Corp.* The Supreme Court in *Container Corp.* stated that it had little competence in determining precisely when foreign nations will be offended by particular acts and how to balance the risk of such retaliation against the sovereign right of the United States as a whole to allow states to tax as they please. *Container Corp., supra* at 194. The letter from Secretary Schultz to Governor Deukmejian cites the United Kingdom's retaliatory legislation as one of the difficulties California's taxing method has precipitated in the conduct of foreign affairs. (Letter at 3.) This is precisely the type of impediment to the conduct of foreign affairs which *Container Corp.* indicated would render a state tax unconstitutional. 463 U.S. at 194.

The Supreme Court further pointed out, in *Container Corp.*, 463 U.S. at 195, that a state tax could have foreign policy implications other than retaliatory legislation, but that the nuances of foreign policy are much more the province of the Federal Executive than the Supreme Court. Since the Federal Executive did not elect to file an *amicus curiae* brief in *Container Corp.*, the Supreme Court assumed that there were no substantial foreign policy considerations which the state tax in that case contravened. Therefore, it upheld the application of the tax in question there to a domestic corporation with foreign subsidiaries. *Container Corp.*

v. Franchise Tax Board, 463 U.S. at 195-196.[16] *Container Corp.* involved the application of California's tax to a domestically controlled group of corporations and it was that issue on which the Federal Executive expressed no view. The Supreme Court in *Container Corp.*, as stated before, expressly reserved judgment on the issue in the instant case. To allay any doubts as to the Federal Executive's position on the issue herein, this *amicus* brief is being filed. Thus, this Court should have no difficulty in determining the Federal Executive's views. The statements of the Secretary of State (Letter) and of the President of the United States (Statement) demonstrate that the Federal Government has a clearly articulated policy in favor of "arm's length" accounting in the conduct of foreign affairs, and that California's worldwide combined unitary business method is in conflict with the internation-

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[16]The trial court below also held California's tax as applied to be unconstitutional as it discriminated against instruments of foreign commerce (CT. 1751-1754) and violated the Due Process Clause (CT. 1754-1756). The trial court found that each foreign nation has its own version of "generally accepted accounting principles" (GAAP), and that a foreign corporation using its own national version of GAAP is able to file an "arm's length" tax return with its own country and with the United States without any inordinate additional expenses. (CT. 1752.) However, a foreign corporation using its national version of GAAP would have to incur an inordinate expense to comply with California's income tax method involved herein. (CT. 1752, 1753.) The trial court found this inordinate expense to discriminate against foreign corporations. (CT 1753.) As an alternative to this inordinate expense the foreign corporation could seek advance rulings from the California Franchise Tax Board or could seek the Board's approval to use estimates instead of actual accounting entries. However, the trial court held that advance rulings and use of estimates was entirely at the discretion of the taxing authorities and such total discretion was a lack of due process. (CT. R. 1754-1756.) The Court of Appeal did not reach this issue as it deemed it unnecessary. (Slip Opinion, pp. 54-55.) We submit that this discriminatory treatment and lack of due process is but another facet of California's tax as applied herein which has exacerbated the Federal Executive's problems in dealing with foreign nations in this area.

ally accepted standard and policies, and custom, and has caused serious disputes and difficulties for the United States in the conduct of foreign affairs. Because of these foreign policy considerations and because of their gravity, the Department of Justice, at the direction of the President, is filing this *amicus curiae* brief.

C. *Appellant's argument*

The Appellant argues (Br. 20-27) that under the rationale of *Wardair* there in affirmative Congressional action allowing California to utilize its apportionment formula in computing appellees' tax liabilities, and that this Congressional action and policy obviates the need for any dormant Foreign Commerce Clause analysis. The Appellant argues (Br. 22) that *Wardair* permitted negative implications to be drawn that the state tax in *Wardair* was permissible under federal law in two circumstances: (1) when there was a treaty restricting the national governments' abilities to tax but not restricting the subnational governments; and (2) when there were treaties restricting the power of subnational governments to enact some taxes but not restricting their power to enact other taxes. (Appellant Br. 22.) The Appellant points to the various bilateral tax treaties between the United States and foreign countries as examples of treaties restricting national governments but not subnational governments, and derives therefrom a negative inference that states are authorized by federal law to impose taxes such as the one at issue. (App. Br. 22-24.) Appellant cites the non-discrimination tax clause made applicable to the states in some of the United States' tax treaties as examples of treaties which restrict some state tax powers, but not other state tax powers, and thus form a basis for implying that the non-banned powers are authorized as a matter of federal law. (App. Br. 26-27.) Appellant concludes that the negative implications to be drawn from the above described treaties amounts to a clear federal congressional decision authorizing the state tax method in issue, and thus, under *Wardair* negates any dormant Foreign Commerce Clause analysis under *Container Corp.* (App. Br. 20-27.)

The Court of Appeal (Slip. Op. pp. 22-30) correctly pointed out that *Wardair* provides no support for Appellant's argument.

Wardair involved a situation wherein the plaintiff, a Canadian company engaged only in foreign commerce, claimed that Florida's imposition of a sales tax on aviation fuel purchased by the carrier in Florida was unconstitutional under the Foreign Commerce Clause as it impaired the United States' ability to speak with one voice in the conduct of foreign affairs. The Supreme Court in *Wardair*, however, decided the case against the taxpayer finding that there was an affirmative federal policy allowing such taxation. This finding was based upon the Chicago Convention, the Federal Aviation Act, and more than 70 bilateral agreements on aviation to which the United States was a party. In 1944 the United States and 156 other nations, including Canada, became signatories to the Chicago Convention. *Wardair Canada*, 477 U.S. at 10. This convention expressly addressed the sales and use tax problem on aviation fuel, and explicitly prohibited only the imposition of such taxes with respect to fuel on board a foreign carrier when it entered the taxing jurisdiction. *Ibid.* at 10. The necessary negative implication of this provision was that other local sales and use taxes on aviation fuel were not prohibited. *Ibid.* at 10. The Supreme Court in *Wardair* also pointed out that Section 1113 of the Federal Aviation Act addresses the problem of state taxation of air commerce expressly forbidding some state taxes and expressly allowing certain state taxes. *Id.* at 6. Among the permissible taxes under that statute are state sales and use taxes. *Id.* at 7. Next the Supreme Court in *Wardair* noted that after the Chicago Convention addressed the state sales tax issue in 1944, the United States entered into more than 70 bilateral aviation agreements, most of which explicitly prohibited national taxes on aviation fuel used by carriers of the other contracting party, but none of which interdicted state taxes on such fuel. *Id.* at 11. The Supreme Court in *Wardair* held that the Chicago Convention demonstrated the United States' and the international community's awareness in 1944 of the state and local sale taxation problem with respect to aviation fuel, and the provisions of that convention represented a decision by the parties to the convention to address the problem by curtailing and limiting only some of the local taxing authorities' power to tax, thereby preserving other aspects of that local power to tax. *Id.* at 10. Further, the Supreme Court found that in the 70 bilateral aviation agreements

entered into since the Chicago Convention, the United States was aware of the sales tax problem, knew of the Chicago Convention's treatment of the problem, and elected not to change that treatment but knowingly acquiesced in state sales taxation of aviation fuel. *Id.* at 12.

The Supreme Court held these knowing acts formed an affirmative decision and policy by the United States to allow sales taxation of aviation fuel. Accordingly, the Supreme Court found that the United States' position was in accord with Florida's and there was no need to resort to any dormant Foreign Commerce Clause Analysis to see if the tax in question was unconstitutional. *Id.* at 9, 13.

In advancing its argument that a dormant Foreign Commerce Clause analysis is not warranted, the Appellant contends that prior to the ratification of the United States-United Kingdom tax convention in 1978 there were numerous United States tax conventions which did not prohibit the taxation method employed herein. In finding a federal policy favoring the tax there involved, the Appellant equates these tax conventions with the 70 bilateral aviation agreements that the Supreme Court noted in *Wardair*. As the Court of Appeal correctly pointed out (Slip. Opinion, pp. 25-26), Appellant's argument overlooks one significant difference between the 70 bilateral agreements involved in *Wardair* and the tax conventions it cites here which were ratified before 1978. Although both sets of agreements are silent as to the respective state taxation involved, the 70 bilateral agreements involved in *Wardair* were entered into after the Chicago Convention had addressed specific local taxes that were precluded. There are no foundation agreements dealing with the instant issue of state taxation to which the tax treaties can be related. Thus, as the Court of Appeals recognized (*Ibid.*), no negative inference can be drawn supporting the tax method in issue from the fact that the various United States bilateral tax treaties did not purport to restrict state taxing power. None of those treaties, except for the United States-United Kingdom, mentions the unitary tax method. Equally inapposite are the nondiscrimination clauses of the treaties of Friendship, Commerce, and Navigation because the subject matter of such clauses is so dissimilar to clauses

authorizing or prohibiting a particular type of tax or tax method as were present in *Wardair*.

Moreover, as the courts below pointed out (Slip Opinion, pp. 23-24; CT. 1738), the unitary method of taxation was never a serious factor in foreign affairs until it was first applied to foreign controlled multinational corporations in 1972. Indeed, the trial court concluded that one could not realistically determine any such reaction or policy position until Appellant's expanded use of the unitary method of taxing foreign multinational corporations was felt through audits, assessments, protests and negotiations between the United States and foreign governments. (CT. 1738.) Thus, as the courts below concluded (Slip Opinion, pp. 23-24; CT. 1739, 1758-1759), the numerous tax and Commerce, Navigation and Friendship conventions in force as of 1978, which do not address the taxation issue here presented, and of which the treaty parties were not seriously concerned, are of no significance as the 70 treaties were in *Wardair*.

A further ground for rejecting the Appellant's argument that there exists a federal policy allowing the method of taxation here and thus no dormant Foreign Commerce Clause analysis is warranted, is the fact that the Supreme Court, in considering in *Container Corp.* the identical method of taxation involved herein as applied to a domestically controlled and owned unitary group of corporations doing business domestically and overseas, examined the constitutionality of the tax there in issue using a dormant Foreign Commerce Clause analysis. *Container Corp. v. Franchise Tax Board*, 463 U.S. at 185-196. If the Supreme Court in *Container Corp.* had found a Congressional policy favoring unitary taxation of domestically owned multicorporate groups doing business overseas, that would have ended the inquiry and there would have been no need to engage in a dormant Foreign Commerce Clause analysis. But the Supreme Court expressly found no such policies and thus resorted to the dormant Foreign Commerce Clause analysis. *Container Corp. v. Franchise Tax Board,* 436 U.S. at 196. The courts below correctly interpreted *Container Corp.* as holding there is no Congressional policy either for or against such method of income taxation. (Slip Opinion, pp. 29-30; CT. 1758.)

Another ground advanced by Appellant for the existence of a federal policy permitting the tax method in issue is the fact that the Senate in 1978 approved the United States-United Kingdom Tax Convention with a reservation negating language contained in Clause 9(4) which would have barred California's tax in this case. (Appellant Br. 14-16, 25.) Both the Court of Appeal and the trial court below specifically addressed this argument and correctly found it without merit. (Slip Opinion, pp. 28-29; CT. 1739-1740.) The trial court noted that the Federal Executive had inserted Clause 9(4) in the proposed United States-United Kingdom tax convention at the insistence of the United Kingdom and that Clause 9(4) would have barred the application of the instant tax. (CT. 1739.) However, the Court of Appeal and the trial court pointed out that when a reservation to Clause 9(4) was introduced in hearings before the Senate Finance Committee on the proposed tax convention, the Committee defeated the reservation by a vote of 10 to 5; next on the Senate floor this reservation to Clause 9(4) was defeated by a vote of 44 to 34. (Slip Opinion, p. 289; CT. 1739.) On this basis the proposed tax convention was submitted to the Senate for a vote for ratification and the Senate voted 49 to 32 for ratification, 5 votes short of the ⅔ vote necessary for ratification. (Slip Opinion, p. 28.) Next the Senate reserved Clause 9(4) without a vote and the tax convention was approved with the reservation. The Court of Appeal and the trial court in their opinions expressly noted that the reservation to Clause 9(4) received a minority of votes in each of 3 votes: the vote in committee and the votes on the floor of the Senate. (Slip Opinion, p. 28; CT. 1739.) Accordingly, the courts below held that this vote represented not a vote for a policy favoring the allowance of states to impose the worldwide combined unitary business method of income taxation, but rather represented a preference, not amounting to a policy, against such a method of income taxation. (Slip Opinion, p. 29; CT. 1740.) The Court of Appeal stated that it failed to see how three majority votes in the Senate essentially approving Clause 9(4) could be transmogrified into a Congressional of disapproval of Clause 9(4) and approval of the tax method in issue. (Slip Opinion, p. 29.) In any event, in these special circumstances of treaty making does not establish federal policy in favor of such state taxation methods. Therefore,

the Court of Appeal and the trial court rejected this argument and so should this Court.[17]

In view of the foregoing it is submitted that the Court of Appeal correctly concluded that there was no affirmative federal policy permitting California's use of the tax method in issue, and that therefore the issues herein should be resolved by a dormant Foreign Commerce Clause analysis as stated in *Container Corp.* (Slip Opinion, pp. 24-30).

The Appellant argues that the Court of Appeal erred when it found that the United States Executive could be the "one voice" which established a federal policy prohibiting the tax method at issue, rather than the voice of Congress. (Appellant Br. 28-32.) Appellant maintains that the Executive cannot exercise the "one voice" in foreign affairs but only Congress can. (Appellant Br. 29). From this Appellant concludes that the Court of Appeal erred in its dormant Foreign Commerce Clause analysis by considering the Executive's actions as the United States "one voice" speaking in the conduct of foreign affairs. (Appellant Br. 29.) No statutory or case law authority is offered for this argument, and it completely ignores the long and clearly established rule that the Executive Branch conducts the foreign affairs of the United States, and if Congress has not acted in this area, actions of the Executive are the acts of the United States and represent United States' policy until Congress acts to the contrary. *Chicago & Southern Air Lines, Inc. v. Waterman Steamship Corp., supra; United States v. Pink, supra; United States v. Belmont, supra; United States v. Curtiss-Wright Export Corp., supra; Oetjen v. Central Leather Co., supra,* see also: *Dames & Moore v. Regan*, 453 U.S. 654 at 678-684 (1981).

Appellants also argue (Br. 28-29) that the Court of Appeal erred in its dormant Foreign Commerce Clause analysis by

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[17]It is absurd to conclude, as does the Appellant, that three losing minority votes in the Senate against the reservation of Clause 9(4) could be the basis of a policy position of the whole Senate.

looking to the Executive Branch for a federal directive and policy. Appellants lose sight of why the Court of Appeal looked to federal policy as expounded by the Executive Branch. That Court followed faithfully the directions of the Supreme Court in *Container Corp.*, which mandates that state taxing practices must give way if they intruded into the conduct of the foreign relations of the United States and interfered with the conduct of foreign affairs. The Court of Appeal specifically found that the tax method in question was in conflict with the norms and standards of international commerce, had offended numerous foreign countries, caused a number of disputes and problems in the United States' conduct of foreign affairs, and had led to retaliatory legislation by the United Kingdom. (Slip Opinion, pp. 32-34.)[18] The Court of Appeal then concluded (Slip, Opinion, pp. 42-45) that the Federal Executive had exercised its lawful powers in the conduct of foreign affairs in this area in order to eliminate disputes with its trading partners and that contrary state law must give way to the "One Voice" requirement of the dormant Foreign Commerce Clause Analysis. When California frustrates this "one voice" of the federal government speaking in the conduct of foreign affairs, the Foreign Commerce Clause of the United States Constitution is infringed.

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[18]Appellant also argues that the conduct of foreign affairs is not significantly implicated because the retaliation by Great Britain is not justified under United States law. It is submitted that the conduct of foreign affairs is necessarily determined not by whether a foreign country's actions are justified under our law as opposed to foreign law but rather whether there is a dispute with a foreign country and what is the most efficient and beneficial manner of resolving that dispute. Accordingly, whether or not Great Britain's retaliatory legislation is or is not justified under our law is of no great moment. The fact remains that a potentially serious dispute exists with Great Britain, and retaliatory legislation by Great Britain is in place, both of which can have adverse effects on the United States' foreign commercial relations. This alone is a serious matter in the conduct of the United States' foreign affairs which must be addressed by the Federal Executive.

CONCLUSION

For the reasons stated above, the decision below is correct and should be affirmed on the ground that the method of taxation involved is unconstitutional as it impairs the United States' ability to speak with one voice in an area where federal uniformity is essential.

Respectfully submitted,

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MAY 1991

APPENDIX A

THE SECRETARY OF STATE
WASHINGTON

January 30, 1986

Dear Governor Deukmejian:

As you are aware, federal legislation was recently introduced with the full support of the Administration which would prohibit states from taxing corporations under the worldwide unitary method and from taxing more than an equitable share of foreign source dividends. This action was taken at the express direction of the President. I am writing to explain to you the foreign policy concerns that prompted this legislation and to urge you to act promptly to reconsider your state's use of the worldwide unitary method of taxation.

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different methods are in use for making the determination with respect to transnational income: separate accounting and worldwide unitary combination. The longstanding policy of the federal government has been to follow the separate accounting method. The United States has advocated and adopted the position that the "arm's-length" adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed. This view is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. It is prescribed in the model income tax treaties published by the Organization for Economic Cooperation and Development ("OECD") and the United Nations ("UN") and by foreign country tax systems

generally. In contrast, the worldwide unitary method of taxation is followed only by seven of the U.S. states. Your state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states.

In an environment in which separate accounting is the federal policy and the generally accepted international rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs and property values vary sharply on an international basis, the rates of profitability of affiliates operating within and without the jurisdiction of the unitary state are often different. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis. This risk of double taxation may distort investment decisions, thereby reducing the overall flow of investment into the United States.

Our concern over the worldwide unitary method of taxation's inhibiting effect on foreign investment in the United States is shared by many foreign governments. They have advised us of their view that "The [unitary tax] method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." They contend that the unitary method of taxation constitutes "... a serious obstacle to the further development of our trade and investment relationships." (Diplomatic note signed by the Ambassadors of Australia, Belgium, Canada, Denmark, France, Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, and Switzerland.)

The administration of the worldwide unitary method of taxation also imposes unreasonable and costly compliance burdens on an enterprise which is considered to be part of a worldwide unitary group. The information required by the tax authorities of the jurisdiction practicing a worldwide unitary method of taxation may not be readily available to the enterprise and, in the case of foreign-controlled entities which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S.

operations for any other reason, will require costly conversion into a form usable by the jurisdiction's tax authority.

For these reasons I believe state worldwide unitary taxation to be inappropriate. Continued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation. The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies. During my tenure as Secretary of State, this has been a difficult and long-lasting issue. The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.

Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. tax treaty for U.S. corporations operating in worldwide unitary states. This legislation, by virtue of a provision which makes possible the retroactive imposition of heavy penalties, was having a chilling effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States and on their willingness to claim benefits properly available to them under the treaty. While the U.K. has agreed to defer implementation of this legislation for the time being, this incident makes it clear that state worldwide unitary taxation is adversely affecting the United States' foreign economic relations.

While the Administration has proposed federal legislation prohibiting worldwide unitary taxation and limiting state taxation of foreign dividends, I would welcome swift legislative or administrative action by your state to terminate your state's use of the worldwide unitary method of taxation and to limit appropriately your state's taxation of foreign source dividends.

Sincerely yours,

George P. Shultz

APPENDIX B

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release November 8, 1985

STATEMENT BY THE PRESIDENT

Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the *concept* of legislation that would:

1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement"), and

2. Address the question of equitable taxation of foreign source dividends.

We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of *crafting* Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. I am also instructing the Secretary of the Treasury to pursue enactment of the domestic "spreadsheet" legislation, which has been previously proposed, and which is designed to assist nonunitary states with tax enforcement respecting multinational corporations in order to promote full taxpayer disclosure and accountability.

Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach.

CERTIFICATE OF SERVICE

It is hereby certified under penalty of perjury that service of the foregoing brief amicus curiae has been made on counsel by mailing a copy to each on this ____ day of May, 1991, in envelopes, with postage prepaid, properly addressed to each of them, respectively, as follows:

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APPENDIX G

[¶ 401-774] FTB Notice No. 89-714, Franchise Tax Board, November 17, 1989.

Corporation franchise (income) — Refund claims — Deferrals of action on refund claims until outcome of pending appeal.— Deferrals of action on corporate tax refund claims will be available to taxpayers who have filed claims for refund that are limited to the question of law presented in the pending appeal of *Barclays Bank International v. Franchise Tax Board* (see ¶ 401-552 for the lower court's decision). In *Barclays*, the California Court of Appeal has been asked to decide the "one voice" issue; that is, whether, in determining the corporate tax liabilities of an entity that is part of a multinational enterprise involving a foreign parent corporation, California's imposition of the requirements of the worldwide combined reporting is consistent with the federal foreign affairs powers contained in the Commerce Clause of the United States Constitution.

No deferrals will be available for claims for refund that raise factual issues such as whether a unitary business exists or whether an individual taxpayer's cost of compliance is constitutionally impermissible; those claims will be acted upon using existing procedures.

Deferrals will be available only when the matter is in the claim status, with no action having been taken with respect to the claim. The notice outlines how this requirement applies at the audit level, the protest level, and the appeal level. A taxpayer seeking deferral of action should specify in the taxpayer's claim for deferral that the claim is limited to the "one voice" issue currently before the Third Appellate District Court in the *Barclays* case, and that the taxpayer requests deferral of action pending the outcome of that case pursuant to FTB Notice 89-714.

Supreme Court, U.S.
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No. 92-212

In The

Supreme Court of the United States

October Term, 1992

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

On Petition For A Writ Of Certiorari
To The California Supreme Court

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether there is a "final judgment" under the jurisdictional test set by 28 U.S.C. § 1257 when the California Supreme Court has decided a Foreign Commerce Clause issue but has remanded the state tax refund case to a lower California court for consideration of due process issues which, if all were determined in taxpayers' favor, would result in a complete judgment for taxpayers.

2. If this Court has jurisdiction to consider this case at this time, whether the California Supreme Court properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of the Barclays taxpayers.

3. If there is such jurisdiction, and if there has been no violation of the Foreign Commerce Clause, whether California's application of worldwide combined reporting to the Barclays taxpayers was nevertheless preempted by the United States Constitution as an intrusion into an inherently federal area; specifically, whether the Executive Branch's foreign affairs powers can eclipse Congress' exercise of its treaty and Commerce Clause powers to permit such state use of worldwide combined reporting.

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No. 92-212

In The

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BARCLAYS BANK PLC,

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FRANCHISE TAX BOARD,
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Respondent.

On Petition For A Writ Of Certiorari
To The California Supreme Court

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

JURISDICTION

Petitioner Barclays Bank PLC ("Barclays"), successor in interest to taxpayers Barclays Bank International, Inc. ("BBI") and Barclays Bank of California ("Barcal"), invokes jurisdiction under 28 U.S.C. § 1257(a). Respondent Franchise Tax Board argues below that there is not yet any final judgment from the California courts in this litigation.

STATUTORY AND CONSTITUTIONAL PROVISIONS

Petitioner Barclays has included some of the relevant constitutional and statutory provisions in Appendix D to the petition. Appendix A to this brief in response contains the following: a portion of article II, section 2 of the United States Constitution; a portion of 28 U.S.C. § 1257(a); and California Revenue and Taxation Code section 25110.

SUPPLEMENTAL STATEMENT OF THE CASE

Respondent Franchise Tax Board believes that petitioner Barclays' statement regarding the case (Petition for Certiorari ("Pet.") 3-14) contains significant omissions. Therefore, pursuant to Rule 15.1, the Franchise Tax Board provides this Court with this supplemental statement. This supplement, which is not necessary to the jurisdictional argument presented below at pp. 8-17, should be read in conjunction with and in addition to both Barclays' statement and the California Supreme Court's statement of the factual, procedural, legislative and case law background, which is included herein by reference. Most citations herein are to the appendices to the Petition for Writ of Certiorari.

1. The California Tax Filings of Petitioners and the Adjustments Made by the Franchise Tax Board.

The Barclays Group conducted its business in California through two corporate entities during the year in issue. Barclays Bank of California ("Barcal"), a wholly

owned, California incorporated, subsidiary of Barclays Bank International Limited ("BBI"), conducted a commercial banking business in the State of California. C-38, #9. BBI, a wholly owned, United Kingdom incorporated, subsidiary of Barclays Bank Limited ("BBL"), conducted business in California as a banking agency. C-36, #1. BBI was engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories during 1977. C-37, #2.

Both corporations filed California Franchise Tax returns for the year at issue. Barcal filed a return which included in its calculations only its individual income and activities. C-39-40, #19. BBI filed a return based upon a worldwide combined report which included all of its worldwide income and activities, and the worldwide income and activities of all of its controlled subsidiaries, including Barcal. C-39, #18. The income which served as a measure of BBI's California tax was determined by applying an apportionment formula, which compared BBI's California activities to the worldwide activities of BBI and its subsidiaries, to the worldwide net income of BBI and its subsidiaries.

At audit the Franchise Tax Board determined that Barcal, BBI and all of BBI's other subsidiaries were part of a single unitary business which also included BBL, the parent company of BBI, and all of the other controlled subsidiaries of BBL. C-38, #14. As a result of this determination the Franchise Tax Board recomputed the California tax liabilities of Barcal and BBI upon the basis of a combined report which included all of the income and activities of the entities determined to be in the unitary

business, from which the California net incomes of Barcal and BBI were reached by formulary apportionment. C-38, #15; C-39, #16; A-5. For purposes of this litigation it is agreed that BBL and all of its majority-owned subsidiaries, including BBI and Barcal, are a single unitary business. A-2, C-37 #8, C-42 #27.

BBI and Barcal pursued administrative remedies with the Franchise Tax Board, and modifications were made to the original audit calculations of the amount of income attributed to California. BBI and Barcal paid the modified assessments and filed a suit for refund asking for the return of all tax and interest amounts paid which were over the amounts paid with their original returns. Neither BBI (C-41, #25) nor Barcal (C-41, #24) have claimed that the amount of tax paid with their original returns was erroneous.

2. Awareness of the Use of the Worldwide Combined Report Method of Determining Income.

There is evidence which suggests international awareness of the use of formula apportionment and the unitary method at least from the mid-1950's on. A-33. As early as the late 1940's the United States negotiators of Friendship Commerce and Navigation agreements recognized the existence of formulary approaches. A-34. The use of formula apportionment as an alternative to the arm's-length/separate accounting method penetrated the international financial and diplomatic consciousness as early as 1924. A-32.

The debate on the States' use of worldwide combined reporting ("WWCR") methodologies was recognized by

the Executive Branch of the federal government as spanning at least two decades as of 1984. A-33, n. 14. Congressional bills dealing in part with the subject of the states' use of WWCR have been introduced since at least 1965 (A-31) and have included measures sponsored by the United States Treasury. For over 25 years senior tax and foreign policy officials of the Executive Branch had been aware of the complaints and demands of foreign governments regarding worldwide combined reporting. A-27.

3. The United States/United Kingdom Tax Treaty.

In 1975, the Ford administration concluded negotiation of a bilateral income tax convention ("US/UK Treaty") with the United Kingdom which would have prevented the use of the WWCR methodology here at issue. A-28. In 1978, with explicit recognition of the "negative implications" of its act, the United States Senate *rejected* the income tax convention negotiated by the executive branch. A-27. It was only approved after the clause limiting the states' use of worldwide combined reporting was removed. A-27. In the wake of the Senate rejection of the limiting clause, the executive scuttled its effort to achieve a treaty-imposed curb on the states' use of WWCR. A-28 and A-37, n. 20.

The Parliament of the United Kingdom ratified the treaty in 1980, without the clause prohibiting the states' use of WWCR. A-30, n. 11 and C-56, #40gg. The ratification occurred after representative of the two countries negotiated the Third Protocol to the Treaty. C-56, #40gg.

In 1985 Parliament enacted legislation which empowered the Prime Minister to institute retaliatory taxation against United States companies if the use of WWCR was continued. C-49, #34. This power has never been exercised. The Executive Branch has indicated to Congress that exercising this power would constitute a clear violation of the treaty by the United Kingdom. Exh. 37i, p. 12.

4. The California Water's-Edge Election.

In 1986 California enacted legislation which allows both foreign and domestic based businesses to elect out of the use of WWCR in favor of a "water's-edge" method, which in general confines WWCR to United States incorporated entities, certain tax advantage subsidiaries of United States corporations and, in limited circumstances, some portion of foreign incorporated entities. A-36 and C-73, #55; Cal. Revenue and Taxation Code § 25110 (see Appendix A hereto). The enactment of the California water's-edge legislation prompted senior Treasury officials to retreat from their previous insistence that Congress prohibit state use of worldwide formula apportionment. A-36-37.

5. This Court's Recognition of the Merits of Formulary Apportionment.

As noted above, worldwide combined reporting is based upon formulary apportionment of the total net income of a unitary business. Use of such formula apportionment of income does not result in a taxation of non-

California corporations or in a taxation of non-California income; it is only the means of determining what portion of the unitary income can be fairly attributed to the part of the unitary business that is actually being carried out in California. *Container Corporation* v. *Franchise Tax Board*, 463 U.S. 159, 164-65, 184, 192 (1983) (hereinafter "*Container*").

The *Container* decision, *id.*, upheld the merits of California's use of unitary apportionment and WWCR as to worldwide unitary businesses headed by domestic corporations. The *Container* Court held California's version of WWCR to be a "proper and fair method of taxation" (463 U.S. at 184) which reflects "a reasonable sense of how income is generated" (*id.* at 169-70) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181), the alternative to WWCR which petitioner Barclays claims must be applied to the Barclays taxpayers. Among the separate accounting weaknesses pointed out in *Container* are that separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" (*id.* at 164-65).

As this Court stated in *Trinova Corp.* v. *Michigan Dept. of Treasury* , ___ U.S. ___, 111 S.Ct. 818, 831 (1991), "since *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned [by geographic designation] to a single source." This Court has very recently stated, "The principal virtue of the unitary business principle of taxation is that it does a better job of accounting

for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

ARGUMENT

I

THIS COURT HAS NO JURISDICTION TO CONSIDER THIS CASE AT THIS TIME, FOR THE CALIFORNIA SUPREME COURT'S DECISION, WHICH REMANDED THE CASE TO THE COURT OF APPEAL FOR CONSIDERATION OF TAXPAYERS' DUE PROCESS ISSUES, IS NOT A "FINAL JUDGMENT" AS REQUIRED BY 28 U.S.C. § 1257.

The ultimate issue to be finally determined in a taxpayer's tax refund suit is whether the taxpayer has overpaid its tax. *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932). That issue clearly has not yet been determined by the California courts. The California Supreme Court has decided the Foreign Commerce Clause issue in favor of the Franchise Tax Board, and it has remanded the case back to the California Court of Appeal for consideration of due process issues. If all those due process issues were to be determined in taxpayers' favor, taxpayers would then receive a final and favorable California judgment for refunds of their taxes as prayed for in their complaints. Such a judgment in favor of taxpayers would render moot the Foreign Commerce Clause issue and holding as to this case, unless the Franchise Tax Board petitioned this Court

for relief from the Due Process Clause judgment and taxpayers preserved the Foreign Commerce Clause issue in their response. On the other hand, if taxpayers ultimately lose the Due Process Clause issue in a final judgment rendered by the highest California court in which a decision could be had, there can be no question that taxpayers then properly could raise both the Due Process Clause issues and the Foreign Commerce Clause issues in a petition for certiorari to this Court. *Hathorn* v. *Lovern*, 457 U.S. 255, 261 (1982); accord, *California* v. *Rooney*, 483 U.S. 307, 311-12 n. 2 (1987).

Under these circumstances, is the California Supreme Court's May 1992 interlocutory opinion a "final judgment" for purposes of section 1257 jurisdiction? Proper application of this Court's recent decisions establishes that it is not.

28 U.S.C. § 1257 limits the jurisdiction of this Court in state-originated cases to "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had. . . . " "In general, the final-judgment rule has been interpreted 'to preclude reviewability . . . where anything further remains to be determined by a state court, no matter how dissociated from the only federal issue that has finally been adjudicated by the highest court of the State.' *Radio Station WOW, Inc.* v. *Johnson*, 326 U.S. 120, 124 (1945)." *Flynt* v. *Ohio*, 451 U.S. 619, 620 (1981). One of the goals behind the final-judgment rule is to avoid piecemeal review of the various federal issues which might be present in a particular case. See *id.* at 621. If this Court were to take this case now and sustain the California Supreme Court on the merits of the Foreign Commerce Clause issue, this

Court could well then be faced, either later this term or next term, with a petition from a final California decision on Due Process Clause issues in the same litigation.

Barclays, citing *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), argues that the California Supreme Court's decision "meets the criteria established by this Court for finality under 28 U.S.C. § 1257 where further state proceedings may occur. *Cox*, 420 U.S. at 476-87." Pet. 27. But Barclays never singles out nor completely sets forth any of the four *Cox* exceptions to the general rule. The reason for this omission is clear: Barclays' circumstances meet none of the four exceptions in *Cox*.

The *Cox* decision provides "a limited set of situations" which provide exceptions to the above general rule. *O'Dell* v. *Espinoza*, 456 U.S. 430 (1982). There are four categories of cases listed in *Cox* as comprising that limited set of exceptions. The first and third categories are not pertinent here.[1] The second and fourth categories deserve attention.

The wisdom of applying the final-judgment rule to deny jurisdiction in this case can be demonstrated by a

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[1] The first exception does not apply here because the Foreign Commerce Clause determination is not conclusive of the rest of the state proceedings – the case is not for all practical purposes concluded. See *Cox*, 420 U.S. at 479. The third exception is not applicable here because Barclays would be able to seek review in this Court on the Foreign Commerce Clause issue if Barclays were to lose on the merits in the further California proceedings. See *Cox*, 420 U.S. at 481; see also *Hathorn* and *Rooney*, cited above at p. 9.

close analysis of the second *Cox* exception. *Cox* presents the second exception as follows:

> "Second, there are cases such as *Radio Station WOW, supra,* and *Brady v. Maryland,* 373 U.S. 83 (1963), in which the federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings. In *Radio Station WOW,* . . . [t]he federal issue was held reviewable here despite the pending [state proceedings] on the 'presupposition . . . that the federal questions that could come here have been adjudicated by the State court, and that the [further state proceedings] could not remotely give rise to a federal question . . . that may later come here. . . . ' 326 U.S., at 127. . . . Nothing that could happen in the course of the [further state proceedings], short of settlement of the case, would foreclose or make unnecessary decision on the federal question." 420 U.S. at 480.

The second exception in *Cox* is premised upon two conditions: (1) that no further decision of the state courts will render moot the federal question which has already been decided, and (2) that no other federal question will be a subject of the state court proceedings to come. Barclays argues in part that this Court should take jurisdiction immediately in order to keep the Foreign Commerce Clause question from becoming moot. To the contrary, the second exception in *Cox* establishes that if the federal question might be rendered moot in the further state proceedings, that usually is sufficient reason to find that there has *not* been a "final judgment" in the state courts. This approach is tied to this Court's recognition that the final-judgment limitations on this Court's jurisdiction are

closely connected to the " 'policy of strict necessity in disposing of constitutional issues. . . . ' " *Minnick* v. *California Dept. of Corrections*, 452 U.S. 105, 122-23 & n. 30 (1981).

By also conditioning this second exception in Cox upon the absence of any possibility that any other federal question might arise in the remaining state court proceedings, this exception avoids the possibility of there being two or more "final judgments" in the same state case, a situation which could give rise to piecemeal consideration by this Court of various federal issues in the same state case. The present case provides an example: immediate consideration on the merits of Barclays' Foreign Commerce Clause claims could well be followed soon by another petition on Due Process Clause grounds, with both petitions arising from exactly the same California litigation. To avoid this situation, this Court has held that when further state proceedings are *necessary* to resolve another federal question, there is no "final judgment" and thus no jurisdiction under section 1257. *San Diego Gas & Electric Co.* v. *San Diego*, 450 U.S. 621, 633 (1981).

Although the second *Cox* exception clearly does not apply to this case, its consideration in the context of this case demonstrates some of the reasons why the present case should not be excepted from the general rule. Any attempt to expand any other exception from *Cox* in order to apply it here should be given extremely careful scrutiny.

Without being specific, Barclays refers to just a portion of the fourth exception in *Cox*. In order for this Court to have jurisdiction, Barclays must establish that this case

now meets *all* of the necessarily intertwined conditions of the fourth exception. See *Flynt* v. *Ohio*, 451 U.S. 619. That exception requires that (1) "the federal issue has been finally decided in the state courts with further proceedings pending in which *the party seeking review here might prevail on the merits on nonfederal grounds*, thus rendering unnecessary review of the federal issue by this Court," (2) "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action rather than merely controlling the nature and character of, or determining the admissibility of evidence in, the state proceedings still to come," and (3) "a refusal immediately to review the state-court decision might seriously erode federal policy. . . . " *Cox*, 420 U.S. at 482-83 (emphasis added).

The first requirement for this exception is not met by this case. While the Franchise Tax Board has argued that there are California procedural bars to the consideration of the due process claims on their merits, there is no way that Barclays can ultimately prevail on the merits in the further state proceedings without establishing that there has been a denial of due process of law.[2]

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[2] Although article I, section 7 of the California Constitution also guarantees "due process" rights, that provision has not been interpreted in tax cases as providing any rights different from those guaranteed in the federal Due Process Clause. See *Cohan* v. *Alvord*, 162 Cal.App.3d 176, 184-86 (1984); *Illinois Com. Men's Assn.* v. *State Bd. of Equalization*, 34 Cal.3d 839 (1981). In this case the Barclays taxpayers have never argued to the California courts that the California due process guarantee has a broader coverage here than the federal Due Process Clause.

The third requirement for this *Cox* exception also is not met in this case. The third requirement has been satisfied in cases where First Amendment rights are directly at stake in the delays involved in further state proceedings (see, *e.g.*, *Fort Wayne Books, Inc.* v. *Indiana*, 489 U.S. 46, 55-56 (1989)) and cases where the federal question involves such procedural questions as proper jurisdiction, venue, or arbitration with regard to which the claimed federal interest would be sacrificed or seriously undermined by continuation of contrary state court procedures (see, *e.g.*, *Southland Corp.* v. *Keating*, 465 U.S. 1, 6-9 (1984); see also *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), and *Construction Laborers* v. *Curry*, 371 U.S. 542 (1963), which are cited as examples for the fourth exception in *Cox*, 420 U.S. at 483, and in *Flynt* v. *Ohio*, 451 U.S. 619, 622 (1981)).

In *Flynt*, *id.*, this Court refused to consider whether permitting a particular criminal prosecution to proceed in state courts was violative of the Equal Protection Clause, holding that the resolution of that question could await final state judgment without "any adverse effect upon important federal interests." *Id.* at 122. This Court reached this holding even though the first two conditions of the fourth *Cox* exception were met. In the words of this Court, "A contrary conclusion would permit the fourth exception to swallow the rule." *Id.* at 622. In other words, the mere fact that the state courts had reached their final holding on a vital federal constitutional issue does not mean that a delay in United States Supreme Court review of that holding will "seriously erode federal policy."

Barclays argues that failure to give immediate review to the California Supreme Court's interlocutory decision

would seriously erode an alleged "federal economic policy of promoting a uniform standard for division of income for tax purposes between nations."[3] Barclays fails to explain why Barclays' purported economic policies somehow must be protected immediately in this case while the Equal Protection Clause claims in the criminal proceedings in *Flynt* could wait.[4]

Barclays fails to recognize that there is an extremely strong federal policy of comity which would be seriously eroded if Court *were* to take this case at this juncture. This Court has long recognized that " 'the modes adopted [by the states] to enforce the taxes levied should be interfered with as little as possible.' " *Fair Assessment in Real Estate*

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[3] Barclays fails to recognize that if, as the California Supreme Court has held, Congress has taken this case out of the dormant Commerce Clause context by acquiescence in California's taxing procedures, there can be no federal economic policy which can overshadow this congressional position.

[4] In making this argument, Barclays also fails to inform this Court that under current California law, Barclays subsidiaries doing business in California can choose to not have worldwide combined reporting used in the determination of their taxes; thus such Barclays subsidiaries do not need to experience worldwide combined reporting while the California state court proceedings proceed to a truly final judgment. See Pet. App. A-36 & n. 19, citing Cal. Rev. & Tax Code § 25110 et seq. Barclays also fails to inform this Court of two other cases (*Alcan Aluminum Corporation* v. *Franchise Tax Board*, Cal. Ct. of Appeal Nos. 2 Civ. No. B065648, 3 Civ. No. 11530), currently proceeding in two separate districts of the California appellate courts, wherein another taxpayer is actively raising the same Foreign Commerce Clause issue which Barclays wishes to argue now in this Court. Thus even if the Foreign Commerce Clause issue is mooted out in Barclays' further state court proceedings, another taxpayer may soon be asking this Court to consider it.

Assn. v. *McNary*, 454 U.S. 100, 102 (1981), quoting *Dows* v. *Chicago* 11 Wall. 108, 110 (1871).[5] In *Fair Assessment* this Court held that, as long as the state legal tax remedies were "plain, adequate, and complete," the above fundamental principle of comity in determining constitutional issues in state tax cases overcame the doctrine, enunciated in *Monroe* v. *Pape*, 365 U.S. 167 (1961), that comity does not apply in civil rights damages cases brought under 42 U.S.C. § 1983. 454 U.S. at 116.[6] This fundamental federal principle of comity with regard to state taxes certainly outweighs and overwhelms Barclays' purportedly applicable economic policy. Given this fundamental federal principle of comity in cases dealing with state taxes, a principle which strongly favors allowing state tax proceedings to go to true completion before reviewing any federal issues in this Court, it is even more clear that *Cox*'s fourth exception to the "final judgment" rule does not apply in this case.

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[5] In 28 U.S.C. § 1341, which bars the federal district courts from jurisdiction to enjoin the assessment or collection of state taxes where there is a plain, speedy and efficient remedy in the state courts, "Congress also recognized that the autonomy and fiscal stability of the States survive best when state tax systems are not subject to scrutiny in federal courts." *Fair Assessment in Real Estate Assn.*, 454 U.S. at 102-03. "This legislation, and the decisions of this Court which preceded it, reflect the fundamental principle of comity between federal courts and state governments that is essential to 'Our Federalism,' particularly in the area of state taxation." *Id.* at 103.

[6] This Court has specifically held under 28 U.S.C. § 1341 that the California tax refund remedies now being pursued in the California courts are plain, speedy and efficient. *Franchise Tax Bd. of Cal.* v. *Alcan Aluminium*, 493 U.S. 331, 338-41 (1990).

There has been no final judgment in the California courts as jurisdictionally required by 28 U.S.C. § 1257. Barclays' current petition for certiorari should be denied.

II

THE CALIFORNIA SUPREME COURT HAS PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

Respondent Franchise Tax Board submits that, even if this Court did have jurisdiction to grant Barclays' petition, the California Supreme Court has correctly applied existing precedent of this Court. Under these circumstances there would be no need for this Court to exercise its jurisdiction.

The California Supreme Court's Commerce Clause holding is based upon an application of *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986) (hereinafter "*Wardair*"), to conclude that Congress has acted to acquiesce in the state tax practice which Barclays is challenging. That being so, the California Supreme Court pointedly did not engage in any dormant Commerce Clause analysis. A-39.[7] Barclays spends most of its

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[7] Given the California Supreme Court's holding, respondent Franchise Tax Board will not in this response engage in a lengthy dormant Commerce Clause analysis. No admission should be inferred from this attempt at succinctness; the Franchise Tax Board stands ready to establish its dormant Commerce Clause position if called upon to do so by a granting by this Court of Barclays' petition.

petition attempting to make points which only are relevant to a dormant Commerce Clause analysis. Other than a few citations, Barclays confines its *Wardair* contentions to two partial pages near the back of its petition. Pet. 22-23.

In *Wardair* this Court cautioned that "It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to reverse the policy that the Federal Government has elected to follow." *Id.* at 12. In criticizing the California Supreme Court for "disregard[ing]" established dormant Commerce Clause criteria (Pet. 17) in a case where Congress has acted to allow the state tax practice in issue, the Barclays petition attempts to lead this Court into just such an upended and illogical exercise.[8]

In *Container Corp. of America* v. *Franchise Tax Board*, 463 U.S. 159 (1983) (hereinafter "*Container*"), this Court held that California's worldwide combined reporting method as applied to a multinational unitary business with a domestic ultimate parent was constitutional. This Court reserved the question of whether it would reach

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[8] There is no need or basis to apply in this case the results or dormant Commerce Clause analysis from such cases as *Kraft General Foods* v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992), cited Pet. at 16, 19, 24, and 26. The fact that the dormant Commerce Clause analysis is broader in the foreign commerce context than in the domestic context (*id.* at 2370) cannot affect Congress' total power to remove *all* Commerce Clause restrictions upon any state tax practice in which Congress chooses to acquiesce. See also n. 11 below at p. 22.

the same result if (as in this case) the ultimate parent corporation were foreign. 463 U.S. at 193-97.[9]

Three years after *Container*, in *Wardair*, this Court provided the analytic tool which, as properly applied by the California Supreme Court to uncontradicted facts in the current record, mandates the resolution of this reserved question in favor of California's use of WWCR. Noting that a *dormant* Commerce Clause analysis should not be applied when federal law indicates an authoritative federal decision to *permit* the challenged state tax, this Court held in *Wardair* that such a permissive decision can exist by *implication*, i.e., under circumstances where

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[9] When dealing with the question of the "one voice" of the federal government in foreign commerce, the *Container* Court only considered whether California's application of WWCR *violated* either one of two branches of the one voice standard, indicating that the state tax "will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government [the dormant clause branch of the standard] *or* violates a clear federal directive." 463 U.S. at 194 (emphasis by the Court). Thus the only non-dormant Foreign Commerce Clause analysis in *Container* was a consideration whether the one voice had spoken to *preempt* California's use of WWCR. *Id.* In the words of the *Barclays* trial court, *Container* "did not address the question of whether such policy was expressed Congressionally *for* it." C-31 (emphasis by the court). The *Container* Court's consideration of "specific indications of congressional intent" (463 U.S. at 196) was restricted to the preemptive analysis, with the Court deciding that "we cannot conclude that the California tax at issue here is preempted by federal law. . . . " *Id.* at 197. Since the *Container* Court did not even consider whether the federal government's one voice had spoken to *permit* California's use of WWCR, it certainly is not inconsistent with *Container* to apply the later *Wardair* analysis in the present case to find such permission.

there is no explicit statement of such permission. Such "implications" are to be drawn from "the *law* as it presently stands," not from any *"aspiration"* for what the law might become. *Id.* at 10 (emphasis by the Court).

In *Wardair*, a Canadian airline challenged Florida's imposition of a tax on all aviation fuel sold within the state insofar as that tax was assessed on fuel used by foreign airlines exclusively in foreign commerce. On the Commerce Clause issue in *Wardair*,[10] the taxpayer and the Solicitor General as amicus curiae argued that the Florida tax unconstitutionally interfered with the ability of the federal government to speak with one voice because there was a federal policy of exempting such fuel from tax. As evidence of the alleged federal "policy," Wardair and the Solicitor General principally relied on (1) the Chicago Convention on International Civil Aviation, an international treaty to which the United States and 156 other countries, including Canada, are parties; (2) a resolution adopted by the International Civil Aviation Organization in 1966; and (3) more than 70 bilateral agreements into which the United States has entered with various countries dealing with international aviation. Discussing each of these in turn, this Court pointed out: (1) that the Chicago Convention by its terms precludes the imposition of local taxes on fuel only when the fuel already is on

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[10] The *Wardair* Court also held that the Florida tax was not preempted by the Federal Aviation Act, but the Court explicitly stated that it did not rely on a permissive provision of that act "to answer the Commerce Clause issue" present in *Wardair*. 477 U.S. at 6-7. Thus Barclays errs in implying (Pet. 23) that the Federal Aviation Act served in any way as a basis for the *Wardair* Commerce Clause holding.

board an arriving aircraft, thus giving rise to the "negative implication" of "a decision by the parties to that convention to address the problem of [state and local taxation] by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority" (*id.* at 10); (2) that the resolution adopted by the ICAO, while it endorses an international scheme of tax exemption, is merely the work product of an international organization of which the United States is a member and has no force of law (*id.* at 11); and (3) that while most of the 70 bilateral agreements commit the United States to refrain from imposing national taxes of the type imposed by Florida, in none of these agreements has the United States agreed to deny the states the power to tax the sale of aviation fuel; in particular, the agreement between the United States and Canada makes *no mention* of taxation by political subdivisions, "an omission which must be understood as representing a policy choice by the contracting parties. . . . " *Id.* at 11.

This Court went on to say:

> "What all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question of whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By *negative implication* arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume

> that drafters from two federalist nations understood this as representing a choice not to preclude local taxation. It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." *Id.* at 12 (emphasis in original).

Thus in *Wardair* the federal government had considered whether to bar a type of tax practice by international agreement, but the *states* were not restricted from applying that tax practice when the agreements were finally adopted as a part of United States law. Under this Court's *Wardair* rule, the implications to be drawn from such an action establish that in formulating federal law Congress has elected to permit the states to apply such a tax practice. *Id.* at 10, 12.[11]

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[11] It must be kept in mind that the United States Constitution gives the power to regulate foreign and interstate commerce to *Congress*. U.S. Const. art. I, § 8(3); Pet. App. D. Thus, as to foreign or interstate commerce matters, congressional action prevails over any conflicting actions or desires of the Executive Branch. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296 (1955). If Congress has exercised its commerce powers so as to permit state action there cannot possibly be any violation of the Commerce Clause; once such permission is ascertained, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co.* v. *Bd. of Equalization* , 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13. In short, in granting such permission Congress is unrestricted by any of the policy standards which would apply in a *dormant* Commerce Clause context.

In holding that the *Wardair* rule was applicable in the present case, the California Supreme Court placed its primary reliance on the United States/United Kingdom ("US/UK") Treaty which was negotiated and ratified in the 1970's. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668 (Exh. 40gg). For the first and only time, the federal Executive Branch negotiated a provision for that treaty, article 9(4), which would have explicitly prohibited any state's use of WWCR. A-29. After much debate, and several votes in the Senate, the treaty was only ratified when that provision was rendered totally inapplicable to the states by a reservation. 124 Cong. Rec. 18416 (June 22, 1978) (Exh. 36c), 19076 (June 27, 1978) (Exh. 36d); A-29. After more bargaining with the United Kingdom, wherein the United Kingdom exacted other federal tax concessions from the United States, the United Kingdom accepted the treaty with the prohibition of WWCR only applicable to the national governments, not to the states. 31 U.S.T. 5709, 5713 (Exh. 40gg). Thus the states' use of WWCR was directly considered as a tax issue in the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be permitted, and a final ratification of a treaty which by clear implication permitted the states' application of that tax practice (WWCR). At the time of the final Senate vote, the clear choice before the Senate was either to ratify the

US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood) (Exh. 36d). By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978) (Exh. 36d). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the use of WWCR by the states, and under the *Wardair* holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.[12]

The California Supreme Court correctly analogized the present case to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra*, 477 U.S. 1, seem to us both evident and compelling. As in *Wardair*, an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals),

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[12] Contrary to Barclays' attempt to characterize the Senate's ratification of the treaty as a "stalemate" (Pet. 23 n. 23), the final outcome was a clear defeat for those who had attempted to bar exactly the type of state tax practice which Barclays is challenging in this case.

> 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair*, the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11.)" A-29-30 (emphasis in original; footnote omitted).

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (A-33-34), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (A-31-34) and in legislative histories of congressional bills (A-31), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers and (2) since Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary. Respondent Franchise Tax Board submits that one does not have to do more than apply the *Wardair* rule to the US/UK treaty to determine that the California Supreme Court's holdings were fully consistent with all current precedents of this Court. The California Supreme Court has not formulated and applied a "new test" of its

own (see Pet. 12, 23, 24) to reach these holdings; it has correctly applied the test provided to it by this Court in *Wardair*. Even if these correct holdings of the California Supreme Court were held to constitute a "final judgment" under section 1257, there would be no need for this Court to take jurisdiction of this case.

III

THE DETERMINATION OF THE FOREIGN COMMERCE CLAUSE ISSUE IN THIS CASE ECLIPSES ANY FOREIGN AFFAIRS PREEMPTION ISSUE.

Even if section 1257 gave jurisdiction to consider a foreign affairs pre-emption issue on the merits, such an issue could not be determinative in this foreign commerce context. It is clear that at the heart of the California Supreme Court's opinion is an issue pertaining directly to the Foreign Commerce Clause. It is undisputed that the Constitution gives to Congress alone the power "[t]o regulate commerce with foreign nations. . . . " U.S. Const. art. I, § 8(3). If, as the Board contends, proper application of the *Wardair* rule in this case confirms that federal law pertaining to foreign commerce contains a permission for the states' use of WWCR, then no contrary foreign affairs aspirations of the Executive Branch could eclipse that permission. The Executive Branch's power in the field of foreign relations, " 'like every other governmental power, must be exercised in subordination to the applicable provisions of the Constitution.' " *Dames & Moore* v. *Regan*, 453 U.S. 654, 661 (1981), quoting *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-20 (1936).

But what of authorities such as *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), and *Zschernig* v. *Miller*, 389 U.S. 429 (1968)? Barclays relies on these cases as barring any state act which has a direct impact upon foreign relations and which may well adversely affect the power of the central government to deal with foreign affairs issues. The answer in this case must be given in the foreign commerce context. If Congress has acted so as to permit state action in a foreign commerce context, no further authorization is needed, even though foreign relations necessarily are also involved. See *Wardair*, 477 U.S. at 12-13; see also *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), *aff'd on other grds.*, 348 U.S. 296 (1955). Alternatively, if there is a dormant Foreign Commerce Clause situation with no clear congressional directive, the *Container* decision teaches that a state tax at variance with the federal tax approach and affecting foreign commerce will violate the Foreign Commerce Clause if it " 'may impair federal uniformity in an area where federal uniformity is essential' . . . and 'prevents the Federal Government from "speaking with one voice" in international trade. . . . ' " 463 U.S. at 194. In reaching its Foreign Commerce Clause holding, the *Container* decision contains many references to "foreign affairs," "foreign relations," and "foreign policy" (see 463 U.S. at 189, 194, 195, 196, 197); it rejected the dissent's position that California's application of WWCR was "an intrusion on national policy in foreign affairs that is not permitted by the Constitution." 463 U.S. at 206 (dissent). Thus *Container* establishes that a holding that WWCR does not violate the dormant Foreign Commerce Clause includes consideration of foreign affairs issues, leaving no room for any determination that the federal

government's foreign affairs powers bar the application of WWCR to that taxpayer. If a state tax affecting foreign commerce is valid either by way of congressional authorization or under the dormant Foreign Commerce Clause tests (which include the balancing of foreign policy considerations), it cannot be made unconstitutional on the basis of infringement upon foreign affairs, particularly since the Congress and the President share authority over foreign affairs. *Container*, 463 U.S. at 196; *Zschernig* v. *Miller*, 389 U.S. 429, 432 (1968).

Application of Barclays' foreign affairs preemption argument in this case would also rewrite the treaty powers provisions of the United States Constitution. Congress, through the Senate's actions on the many bilateral income tax treaties, and through the Senate's action on article 9(4) of the US/UK Treaty, has taken affirmative action which allows the states to tax unfettered by separate accounting restrictions placed on the national government and unfettered by proposed article 9(4), and has therefore impliedly authorized state use of WWCR. This Court cannot construe the Executive Branch's foreign policy aspirations as authoritative federal policy without disabling not only Congress, but also the Constitution, which requires that treaties can become law only upon ratification by two-thirds vote of the Senate. U.S. Const. art. II, § 2 (App. A hereto.) By rejecting the Executive Branch's aspirations which were given voice in proposed article 9(4) of the US/UK Treaty, Congress' implied acquiescence in the state use of WWCR has become a part of the "supreme law of the land" (U.S. Const. art. VI(2); it cannot then be voided merely by relabeling the Executive Branch's thwarted aspirations as "foreign policy."

CONCLUSION

For the reasons given above, it is respectfully submitted that the petition for writ of certiorari should be denied.

Dated: September 1, 1992.

Respectfully submitted,

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APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION

Article II, section 2, clause 2 (in part):

> [The President] shall have power, by and with the advice and consent of the Senate, to make treaties, provided two-thirds of the Senators present concur. . . .

UNITED STATES CODE

28 U.S.C. section 1257(a), in part:

> (a) Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme court by writ of certiorari . . . where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

CALIFORNIA REVENUE AND TAXATION CODE

Section 25110 (water's edge election):

> (a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of

this part, as modified by this article. A taxpayer which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United States is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation

derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income of and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income", of that bank or corporation for that income year and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted.

(B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4) inclusive, and (6) and which is

an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purposes of this article and Section 24411:

(1) An "Affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or a corporation required to file under this part.

(B) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(C) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporation individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this

state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this

subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.

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No. 92-212

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

VS.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Respondent does not deny, nor can it, that this case is of major national and international importance. The United States, the United Kingdom, the United States' major trading partners and all other amici assert that California's application of worldwide combined reporting to foreign taxpayers and to their domestic subsidiaries (i) is at odds with accepted international practice, (ii) has created serious tensions in the United States' conduct of its foreign commercial relations, (iii) has led to threats and enactment of retaliatory legislation and (iv) has seriously undermined the federal government's ability to "speak with one voice when regulating commercial relations with foreign governments." The United States bluntly concludes:

> This Court's resolution of the question presented in this case is of great importance because the analysis applied by the

> California Supreme Court threatens broad impact on the constitutional allocation of authority to the federal government to regulate foreign commerce.

United States Amicus Brief at 15-16.

Further, Respondent does not deny, nor can it, that this case squarely presents the issue which this Court twice reserved in *Container Corp. of America v. Franchise Tax Board,* 463 U.S. 159, 189 n. 26, 195 n. 32 (1983), or that this case contains all of the elements which this Court emphasized as missing in *Container.* Respondent does not deny, nor can it, that the California Supreme Court found affirmative congressional policy where this Court in *Container* found no policy—affirmative or negative —reviewing the same facts. Respondent does not deny, nor can it, that worldwide combined reporting as applied here burdens foreign commerce.[1]

Respondent never addresses the conflict between the decision of the California Supreme Court and this Court's oft-confirmed requirement—both before and after *Wardair Canada v. Florida Department of Revenue,* 477 U.S. 1 (1986)[2] —that congressional consent to remove a state tax from the scrutiny of the commerce clause must be specific, unambiguous and based on an affirmative text. Respondent does not point to that text—nor can it.

Respondent's only response is that all of this is irrelevant because the decision of the California Supreme Court is right. If, as the decision below states, this Court in its *Wardair* decision, a case legally and factually distinguishable from this case, has "reoriented" foreign commerce clause jurisprudence from a consideration of sensitive matters of national sovereignty and foreign relations to a search for the meaning of congressional silence, this Court should say so. If the California court can construct a new test, under which it refuses to follow the analysis of this Court in *Container* on the very question reserved, this Court, not the

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[1] Respondent essentially admits that worldwide combined reporting "has a direct impact upon foreign relations" and "may well adversely affect the power of the central government to deal with foreign affairs issues." Respondent's Brief in Opposition (hereafter "R.B."), at 27.

[2] See *Wyoming v. Oklahoma,* ____ U.S. ____, 112 S. Ct. 789 (1992), which Respondent never mentions.

California Supreme Court, must say that it has overruled *Container* and that the new test is proper.[3] Until then, whether the court below is "right" or not is truly irrelevant.

The balance of Respondent's response rests on the proposition that the California decision does not constitute a final judgment under 28 U.S.C. § 1257. Although Respondent refers to this decision as "interlocutory," the decision represents the final precedential judgment of the highest court in California on these important foreign commerce issues. The subsequent proceedings on the separate due process issue, whatever the outcome, will not affect, or be affected by, that judgment. This Court has recognized that finality is a practical concern which balances the risks of delay in review against the possible costs of piecemeal review. Petitioner has already languished for eight years in the California courts. No purpose is served by further delay. Where, as here, the decision of the court below, separable from and unaffected by the subsequent state proceedings, is eroding basic constitutional policies of uniformity under the dormant foreign commerce clause and undermining the Constitution's allocation of foreign policy matters to the central government, the balance clearly swings to immediate review.

ARGUMENT

I

THIS COURT HAS JURISDICTION OVER THE FINAL DECISION OF THE COURT BELOW ON THE IMPORTANT FOREIGN COMMERCE ISSUES

Respondent argues that the remand of a separate federal question[4] (the due process issue) which cannot affect the foreign commerce issues now finally decided by the California Supreme Court makes that decision insufficiently "final" for purposes of

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[3] This Court frowns on overruling "sub silentio" and it is for this Court, not a lower court, to overrule its decisions. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

[4] Respondent suggests that the Court of Appeal might not even reach the remanded issue because Respondent intends to raise state procedural bars. R.B. at 13. If so, the second federal question disappears.

this Court's jurisdiction under 28 U.S.C. § 1257. Respondent's principal contention is that this Court's tests for finality where there are further state court proceedings, as summarized in *Cox Broadcasting Corporation v. Cohn,* 420 U.S. 469 (1975), bar finality whenever such further state proceedings involve a federal question.

There is no such bar. As this Court has stated many times, the question of finality is a practical one. *See, e.g., Cohen v. Beneficial Indus. Loan Corp.,* 337 U.S. 541, 546 (1949). This Court balances competing policy concerns arising from piecemeal review against the dangers and possible waste of delaying justice. This Court's tests include the presence of a second federal question in that balancing process. *Cox,* 420 U.S. 469; *Flynt v. Ohio,* 451 U.S. 619 (1981). The basic policy question is still whether immediate review better serves the identified concerns.

A. This Court Already Weighs The Effect Of A Second Federal Question As Part Of Its Policies On Finality.

This Court's decisions recognize that some federal issues are so severable or so important that this Court will review a state court decision on them, even though further pending state proceedings involve other federal questions.

In *Hudson Distributors, Inc. v. Eli Lilly & Co.,* 377 U.S. 386 (1964), a case decided prior to *Cox* but described therein as one of the fourth *Cox* "genre," (*Cox,* 420 U.S. at 484 n.11) appellant challenged the constitutionality of the Ohio fair trade law as conflicting with federal antitrust law. Justice Harlan in his dissent pointed out two additional federal questions which would have to be decided on remand to the Ohio Court of Common Pleas (the validity of a contract under the Sherman Antitrust Act and a possible conflict with another decision of this Court) and which might very well return to this Court. 377 U.S. at 386. Nevertheless, this Court reviewed the decision of the Ohio Supreme Court on the initial federal question.[5]

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[5] The type of federal question which *would* bar review is described by this Court in *Cox,* 420 U.S. at 478 n.6, namely eminent domain cases where both the federal question of taking and the federal question of just compensation must be decided in disposing of the constitutional issue.

This Court's decision in *Flynt* illustrates the weight which this Court gives to the competing considerations of a second federal question and an important federal policy. In *Flynt,* after stating that other federal issues would appear to be involved, this Court *nevertheless* considered whether the Ohio judgment denying the pre-trial motion to dismiss on the ground of insufficient evidence might fall within the fourth *Cox* category. In its analysis under this *Cox* test this Court looked only to whether a favorable decision for the petitioners might end the litigation and whether delaying review until conviction would seriously erode federal policy within the meaning of the prior cases.[6]

In this case, there are identifiable and important constitutional policies which are clearly being undermined by the decision of the California Supreme Court.[7] These have implications well beyond the litigants in this case and warrant immediate review.

B. Petitioner Meets The Fourth *Cox* Category.

The *Cox* categories are not as rigid as Respondent contends. *See Cox,* 420 U.S. at 477 ("*at least* four categories"). In any event, Petitioner meets the fourth of such categories. In the alternative, Petitioner meets the second (see subpart C hereafter).

Thus, although there are two federal questions, they are so intertwined as to be integral. *Compare San Diego Gas & Electric Co. v. City of San Diego,* 450 U.S. 621 (1981) *with First English Evangelical Lutheran Church v. County of Los Angeles,* 482 U.S. 304 (1987).

[6] The Court found no identifiable federal statutory or constitutional policy. The equal protection claim of selective prosecution, even though involving obscenity, was no different than any other selective prosecution claim reviewable after conviction and no federal policy barred a trial on dissemination of obscenity.

[7] Respondent contends that the only federal questions found sufficiently important under the *Cox* categories are First Amendment issues or procedural matters. *But see Hudson Distributors,* 377 U.S. 386 (involving antitrust issues) and *Goodyear Atomic Corporation v. Miller,* 486 U.S. 174 (1988) (federal preemption of state regulation of nuclear facilities).

Respondent contends that, if Petitioner prevails on due process grounds, the foreign commerce issue will be moot.[8] If so, Petitioner meets the fourth *Cox* test: (1) the litigation will end if petitioner prevails in this Court, (2) petitioner may prevail below on the merits on other grounds, thus rendering unnecessary review of the issue by this Court and (3) a refusal immediately to review the state court decision might seriously erode federal policy.

Respondent's chief argument is that the decision below on which the Petitioner might prevail must be a nonfederal ground. As *Flynt* shows[9] the fourth *Cox* test has not been interpreted so narrowly. In that test the erosion of federal policy constitutes "sufficient justification for immediate review" (*Cox*, 420 U.S. at 479), even if review could otherwise be avoided because of mootness.

Failure to review here will seriously erode important constitutional policies.

The Constitution allocates to the federal government the power to conduct foreign policy. Although Congress has ultimate authority to regulate commerce, in the absence of congressional regulation the policies of the dormant commerce clause prevail. *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979). The policy of uniformity presumptively prevails when Congress remains silent. *Wardair*, 477 U.S. at 7. Respondent does not deny that there is an accepted uniform standard to divide income among nations for tax purposes and that the California methodology is incompatible with and in conflict with that standard.

Like jurisprudence in the area of the First Amendment, these principles are well-established. However, the decision of the court below, admittedly based on the assumption that the reach of the

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[8] Petitioner does not concede that its foreign commerce causes will be moot if it were to prevail on due process grounds. The matter is not free from doubt however, and it is clear that Respondent would raise such procedural hurdle should Petitioner prevail.

[9] Respondent apparently agrees: Respondent states that in *Flynt* the petitioner met the first two conditions of the fourth *Cox* test even with the likelihood of additional federal questions. R.B. at 14. *See also Hudson Distributors*, 377 U.S. 386.

dormant commerce clause has been limited, erodes these principles.

This Court has affirmed, both before and after *Wardair*, that Congress must speak explicitly and affirmatively to remove state taxes from the scrutiny of the dormant commerce clause. The self-executing nature of the dormant commerce clause, creating a zone of free trade, is undercut by removing the check of explicit congressional action. This also affects the role of the federal executive in foreign policy.

Respondent argues that delay will not harm Petitioner. However, the policies at stake here do not affect just Petitioner or just other taxpayers.[10] Delay, or even worse, failure to review, will result in exactly the harm which these constitutional policies are meant to prevent.

There is urgency. Various governments, including the United States, could be patient while this case proceeded through the state courts: the lower California courts were following this Court's guidelines which take into account the sensitive nature of foreign relations.

But, in May, the California Supreme Court told the international community: (i) it had found an "interpretive framework" for a species of governmental silence that foreclosed resort to a dormant foreign commerce clause analysis, (ii) unswerving opposition to the use of worldwide combined reporting, through the five United States administrations—both Democrat and Republican—which have faced this issue, were nothing more than mere "executive aspirations", and (iii) California's retreat from use of worldwide combined reporting was a mere "meliorative" measure designed to "pacify critics."

Now twenty of the United States' main trading partners, which account for more than half of U.S. trade, tell this Court that they are "anxious" to have the constitutionality of the tax resolved before more harm is done to their relations with the United States. The United Kingdom told the United States government

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[10] However, it is clear that individuals are also entitled to the benefits of commerce clause protection. *Dennis v. Higgins*, ___ U.S. ___, 111 S. Ct. 865 (1991).

that the retaliatory legislation was not a mere ornament on the statute book and that immediate review of the California Supreme Court decision was "essential" to avoid an outcome that could risk damaging relations between these nations (Appendix A to United Kingdom Amicus Brief). Amici Curiae National Foreign Trade Council, Inc., et al., state that review is urgently needed to: "stave off a potentially destructive cycle of international retaliation that would interfere with foreign trade, disrupt international flows of capital and technology, and harm U.S. commercial interests abroad." National Foreign Trade Council Amicus Brief at 4.

The decision of the California Supreme Court, if left unreviewed, is as chilling in its own way on constitutional rights as was the decision of the Georgia Supreme Court in *Cox*. The California decision, left unreviewed, could effectively destroy protections accorded free trade by the dormant commerce clause. The decision has already cast a shadow on the ability of our Nation to conduct its foreign policy. Immediate review is essential to prevent erosion of these important constitutional rights.

C. In The Alternative, Petitioner Meets The Second *Cox* Category.

In the second *Cox* category ("the federal issue, finally decided by the highest court in the State, will survive and require decision regardless of the outcome of future state-court proceedings", *Cox*, 420 U.S. at 480) the key is not the absence of a second federal question. Rather the remaining questions, either state or federal, must be "wholly unrelated to the federal question" on which petitioner seeks review. *Id.* at 478.

This Court confirmed that severability of the remaining issues was the essential element of the second *Cox* test in *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987). That case involved a claim that a prohibition on compensation for regulatory "takings" was unconstitutional. The California courts had assumed that a taking had occurred. This Court characterized *First English* as falling within the second *Cox* category, 482 U.S. at 310 n.3, and granted review because the

California court's assumption "isolate[d] the remedial question for our consideration." *Id.* at 311.[11]

Radio Station WOW v. Johnson, 326 U.S. 120 (1945), cited in *Cox* as an example of the second category, also demonstrates the rule of severability. The *WOW* Court, after noting that "[c]onsiderations of English usage as well as those of judicial policy" would justify a strict rule precluding review where any question remained, concluded that history did not support such a mechanical rule. 326 U.S. at 124-25. In particular, the mechanical rule was not applied where one part of a case is so "dissociated" from another that it is "[i]n effect . . . a multiple litigation allowing review of the adjudication which is concluded because it is independent of, and unaffected by, another litigation with which it happens to be entangled." *Id.* at 126.

The foreign commerce clause issues presented here are independent of the due process issue involving Respondent's regulations. Respondent might be able to fix its regulations, but the foreign commerce questions in the application of worldwide combined reporting would still remain.[12]

II

OTHER POLICY CONCERNS ARE BETTER SERVED BY IMMEDIATE REVIEW THAN BY DELAY

Respondent admits that a decision by this Court in favor of Petitioner on the foreign commerce grounds will end the litigation. This advances the policy concerns over waste. In *Mills v. Alabama,* 384 U.S. 214 (1966) this Court used, as an example of waste, expenditure of further time and energy in the state judicial

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[11] In describing the second *Cox* category, this Court did not list the absence of a second federal question as a requirement. In fact, later litigation did involve substantial federal questions. *See First English Evangelical Lutheran Church v. County of Los Angeles,* 210 Cal. App. 3d 1353 (1989).

[12] The Court of Appeal determined that the due process issue was not necessary to its decision on the foreign commerce clause matters and the California Supreme Court on remand expressly directed the California Court of Appeal to consider the due process issue free of the dormant commerce clause. Appendix B at 36-37; Appendix A at 49-50.

system already troubled by delays due to congested dockets. This case has been in the California court system for eight years, five of them in the appellate system.[13]

There is no interference with the California courts on the issue if this Court grants review. Any concerns of comity have already been met. Petitioner has subjected itself to the California state courts and the highest court of the state in that system has finally decided the issue which Petitioner now seeks to place before this Court.[14]

CONCLUSION

The patience of the international community should not be tested further. This Court should grant review and decide the important foreign commerce issues presented by this case.

Respectfully submitted,

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[13] Respondent's reference to two other cases (there are approximately 30 in the California court system all dependent upon this case on this issue) underscores the waste of judicial resources if this petition is denied. See also Appendix G.

[14] Respondent somewhat ambiguously states that a judgment in favor of the taxpayers on the due process issue would "render moot the Foreign Commerce Clause Issue *and holding* as to this case. . . ." R.B. at 8. Any decision of the Court of Appeal or the California Supreme Court in favor of or against Petitioner on the due process issue will not vacate the decision of the California Supreme Court already rendered. That decision is final, is precedent in California, and is already being applied.

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BARCLAYS BANK PLC, PETITIONER

v.

FRANCHISE TAX BOARD, AN AGENCY OF THE STATE OF CALIFORNIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether, as applied (i) to a domestic corporation that has a foreign parent or (ii) to a foreign corporation that has a foreign parent or foreign subsidiaries, California's use of the worldwide formula apportionment method to allocate income for tax purposes violates the Commerce Clause of the Constitution.

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In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-212

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INTEREST OF THE UNITED STATES

The Constitution confers upon Congress the power to "regulate Commerce with foreign Nations" (Art. I, § 8, Cl. 3) and authorizes the President, "by and with the Advice and Consent of the Senate, to make Treaties" (Art. II, § 2, Cl. 2). The United States has a substantial interest in cases that address the constitutional allocation of authority over matters affecting foreign commerce and foreign relations. This case presents such an issue.

As this Court recognized in *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 184-193 (1983), the United States employs the arm's length method

for allocating income among commonly controlled corporations. This method, which reflects the consistent practice of all major trading Nations, is also required, for federal taxation, by numerous tax treaties to which the United States is a party. California's use of the worldwide combined reporting method for allocating income among a unitary group of multinational corporations conflicts with this uniform international practice and has created an irritant in the commercial relations of the United States and its major trading partners. The Departments of State and Treasury inform us that foreign governments have objected to California's departure from accepted international tax practice and have threatened (or enacted) retaliatory legislation against United States corporations as a result of California's unilateral actions. The State's tax has thus seriously undermined the federal government's ability to "speak with one voice when regulating commercial relations with foreign governments." *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276, 285 (1976).

STATEMENT

1. Two different methods have been used to identify and allocate among taxing jurisdictions the income received by multinational corporations. The method employed by the United States is known as the "separate accounting" or "arm's length" method. This method generally treats each corporation as a distinct tax unit, doing business with every other corporation (including its parent, subsidiaries or affiliates) on an arm's length basis. The separate accounting method of taxation is employed in the Internal Revenue Code and is a central feature of

the many bilateral tax treaties to which the United States is a party (Pet. App. F44). The separate accounting method is also the accepted international standard.[1] It is almost universally applied by foreign tax systems and has been incorporated in the model tax treaties adopted by the United Nations and the Organization for Economic Cooperation and Development (*ibid.*).[2]

The other method of allocating corporate income among taxing jurisdictions is the "worldwide combined reporting" method used by California and two other States. For corporations engaged in a unitary business, California ignores the separate corporate existence of parents, subsidiaries and affiliates, pools their income together, and allocates a portion of that

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[1] The international practice is described in the letter to Governor Deukmejian of California, dated January 30, 1986, from Secretary of State George P. Shultz (Pet. App. F44-F46). See also G. Maisto, *General Report*, in 77a *International Fiscal Ass'n, Cahiers de droit fiscal international (Transfer Pricing in the Absence of Comparable Market Prices)* 19-75 (1992). Maisto notes that the arm's-length method is the primary method for allocating income internationally and that the OECD considers the combined reporting and formula apportionment method of allocating income to be arbitrary. *Id.* at 50-51. Other than in a few States of the United States, the worldwide combined reporting method is not used at the national or sub-national level by the United States or any of its major trading partners or in any of the countries surveyed. *Ibid.*

[2] See OECD Model Double Taxation Convention on Income and on Capital, Art. 7 (1977); Organization for Economic Cooperation and Development Committee on Fiscal Affairs, *Transfer Pricing and Multinational Enterprises* (1979); United Nations Model Double Taxation Convention Between Developed and Developing Countries, U.N. Pub. No. ST/ESA/102, Art. 7 (1980).

combined income to California based upon a multi-factor apportionment formula.[3] See *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 162-163 (1983). California applies its worldwide combined reporting method not only to domestic parent corporations that have foreign subsidiaries (see *ibid.*) but also to domestic subsidiaries (conducting business in California) that have foreign parents and to foreign parents (conducting business in California) that have foreign subsidiaries.

California's application of the worldwide combined reporting method of taxation to corporations doing business in California that have foreign parents or foreign affiliates conflicts with the "separate accounting" method applied under federal law and under established international practice. In letters addressed to the governors of the six States that then employed the worldwide combined reporting method of taxation (Alaska, California, Idaho, Montana, New Hampshire and North Dakota), the Secretary of State expressed the concern of the United States that state use of worldwide combined reporting "is at odds with the position of the United States and has become a source of conflict with foreign states" (Pet. App. F45). The Ambassadors of Australia, Belgium, Canada, Denmark, France, the Federal

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[3] Under the three-factor apportionment formula used by California, the in-state corporation's income is calculated as a percentage of the total income of the group of related corporations. After the unitary business group is identified, the in-state corporation's sales, property, and payroll are expressed as a fraction of the total sales, property, and payroll of the unitary group. These three fractions are arithmetically averaged. This average is then multiplied against worldwide group income to yield the taxable income of the in-state corporation (Pet. App. A5).

Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands and Switzerland have advised the United States that the worldwide combined reporting method of taxation constitutes "a serious obstacle to the further development of our trade and investment relationships" (Pet. App. F45). In particular, the United Kingdom enacted legislation in 1985 that provides for retaliatory tax treatment of United States corporations that operate in the States that apply the worldwide combined reporting method.[4] While the United Kingdom has not yet invoked this legislation,[5] its enactment provides clear indication of the adverse impact that California's method of taxation has on the conduct of foreign economic relations by the United States.

2. The taxpayers involved in this case are Barclays Bank International Limited (BBI) and Barclays Bank of California (Barcal). During 1977, Barcal (a United States corporation conducting banking activities in California) was a wholly owned

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[4] The United Kingdom legislation denies tax credits on the taxes owed by such corporations for dividends they receive from their United Kingdom subsidiaries. See Finance Act 1985, Pt. II, ch. I, § 54, and Sch. 13, ¶ 5 (Eng.), reenacted without substantial change in Income and Corporation Taxes Act 1988, Pt. XVIII, ch. III, § 812 and Sch. 30, ¶¶ 20 and 21 (Eng.). See also Parliamentary Debates (Hansard) 1014-1018 (10 July 1985); Secretary of State Shultz's letter to Governor Deukmejian (Pet. App. F46).

[5] The United Kingdom has stated that the legislation will not apply to dividends paid on or before December 31, 1989. See Joint Report by Inland Revenue and U.S. Treasury, *Unitary Tax: Review of Progress Towards Resolving the Problems*, para. 6.2 (Dec. 1991).

subsidiary of BBI (a United Kingdom corporation conducting an international banking business).[6] Both BBI and Barcal did business in California and were therefore subject to tax in that State (Pet. 3, 4; Pet. App. C36-C38).

In computing its California income tax for 1977, Barcal used the separate accounting method and reported only the income it earned from California sources. In computing its California income tax for 1977, BBI reported not only the income it earned from California sources but also included (i) income BBI earned from operating bank agencies and branches in the United Kingdom and approximately 33 nations or territories outside of the United Kingdom and (ii) the income earned by 70 subsidiaries (including Barcal) of BBI operating in 34 nations or territories outside of the United Kingdom. BBI did not, however, include the income of BBI's parent (see note 6, *supra*) or of the parent's subsidiaries. Thus, neither Barcal nor BI submitted its California tax return under the worldwide combined reporting method required by California (Pet. 7-8; Pet. App. C38-C41).

The California Franchise Tax Board determined that Barcal and BBI were members of a worldwide unitary business conducted by all members of the Barclays Group. That Group included (i) Barcal, a wholly owned subsidiary of BBI doing business only

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[6] BBI was a wholly owned subsidiary of Barclays Bank Limited, a United Kingdom corporation. In 1982, Barclays Bank Limited changed its name to Barclays Bank PLC, which is named as the petitioner in this case (Pet. 2-3).

in California; (ii) BBI, a United Kingdom Corporation doing general retail and commercial banking in the United Kingdom and 34 other nations or territories outside the United Kingdom, including California; (iii) the subsidiaries of BBI in which BBI has more than a 50% interest; (iv) Barclays Bank Limited, a United Kingdom corporation which conducts no business in California and which owns 100% of the stock of BBI; and (v) the subsidiaries of Barclays Bank Limited in which that corporation holds more than a 50% interest. The California Franchise Tax Board calculated the tax owed by BBI and Barcal by allocating a portion of the total income of the above unitary group to these two taxpayers utilizing a three-factor apportionment formula. The State's calculation indicated a tax deficiency, which the Board then assessed (Pet. 7-8; Pet. App. C38-C40).

3. Barcal and BBI challenged the State's assessment because it was based not only on the income that they had separately earned but also on the income of their foreign parent and other related foreign subsidiaries which do no business in California or elsewhere in the United States. After paying the assessments, the taxpayers sued for a refund in California superior court (Pet. App. C38-C41).

The trial court entered judgment in favor of the taxpayers (Pet. App. C1-C34). The court concluded that California's computation of taxes by use of worldwide combined reporting improperly included income earned by foreign parents and affiliates of the taxpayers. The court held that this violated the Commerce Clause of the United States Constitution because it impeded the federal government's ability to speak with one voice in the conduct of foreign

affairs (*id.* at C23-C26), impermissibly discriminated against foreign commerce (*id.* at C26-C28) and violated due process (*id.* at C29-C30).[7]

The California court of appeal affirmed (Pet. App. B1-B37). The appellate court held that California's application of worldwide combined reporting to the income received by foreign parents and affiliates of the taxpayers violated the Commerce Clause because it frustrated the United States' ability to speak with one voice in an area of foreign affairs where federal uniformity is necessary (*id.* at B35).

The California Supreme Court reversed, upholding the constitutionality of the tax under the Commerce Clause as applied in this case. The court relied extensively on the fact that, while Congress has been given many opportunities, it has not enacted legislation to prohibit the States from employing the worldwide combined reporting method to multinational corporations (Pet. App. A28-A31). Concluding from "the din" of this legislative "silence" that Congress "has decided *not* to prohibit state use" of worldwide combined reporting "in cases of this kind" (*id.* at A26), the court declined to apply the Commerce Clause to prohibit the State from enforcing a tax that Congress has not acted affirmatively to prohibit (*id.* at A24-A38).

Since the court of appeal had resolved the case solely under the Commerce Clause, and had not reached petitioner's separate due process challenge to the State's

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[7] The trial court concluded that procedures adopted to implement the State's worldwide combined reporting method violate due process because, "with customarily and currently available acounting data, literal compliance with [their] requirements is impossible for foreign multi-nationals" (Pet. App. C29).

tax (see note 7, *supra*), the California Supreme Court remanded the case to the court of appeal for further proceedings on that issue (*id.* at A39-A40).

ARGUMENT

In *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159 (1983), the Court held that California's use of the worldwide combined reporting method for allocating the income of a unitary business did not violate the Commerce Clause. *Id.* at 184-197. That case, however, concerned application of the worldwide combined reporting method to a domestic parent corporation doing business in California. Recognizing the potentially different and additional considerations involved when the incidence of a state tax falls on a *foreign* corporation, the Court expressly reserved the question whether the California method would be constitutional "with respect to state taxation of domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign subsidiaries." *Id.* at 189 n.26.

This case presents the question that was expressly reserved in *Container Corp.* This Court's resolution of this important question is necessary to avoid continued state action that conflicts with accepted international commercial practice and prevents the United States "from speaking with one voice when regulating commercial relations with foreign governments" (*Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 451 (1979)).

1. Under the Commerce and Due Process Clauses of the United States Constitution, a State, when imposing an income-based tax, may not tax value earned outside its borders. *Allied-Signal Inc.* v. *Director, Division of Taxation*, 112 S. Ct. 2251, 2255, 2258

(1992). The State may, however, constitutionally tax on an apportioned basis the income earned by a corporation in multiple taxing jurisdictions. *Container Corp.* v. *Franchise Tax Board*, 463 U.S. at 164-165. The income to be apportioned must, however, be related to the business carried on in that State. *Allied Signal, Inc.* v. *Director, Division of Taxation*, 112 S. Ct. at 2263. For a tax imposed on an apportioned basis to satisfy the basic requirements of the Commerce Clause, (i) there must be a substantial nexus between the State and the activity or property taxed, (ii) the activity or property must be fairly apportioned to the taxing State, (iii) the tax must not discriminate against interstate commerce, and (iv) the tax must be fairly related to the services provided by the State. *Wardair Canada Inc.* v. *Florida Department of Revenue*, 477 U.S. 1, 8 (1986); *Container Corp.* v. *Franchise Tax Board*, 463 U.S. at 165-171. When the state tax affects foreign commerce, two additional questions must be addressed: "first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments." *Wardair Canada Inc.* v. *Florida Department of Revenue*, 477 U.S. at 8 (quoting *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 451 (1979)). See also *Container Corp.* v. *Franchise Tax Board*, 463 U.S. at 185-187. "If a state tax contravenes either of these [two additional] precepts, it is unconstitutional under the Commerce Clause." *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. at 451.

The Court observed in *Container Corp.* that "a state tax at variance with federal policy will violate

the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." 463 U.S. at 194. The "most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Ibid.*

In *Container Corp.*, this Court considered the constitutionality of California's application of the worldwide combined reporting method to determine the income of members of a unitary corporate group controlled by a domestic parent corporation. Noting that the United States had not filed a brief in that case (463 U.S. 195-196 and n.33)[8] and that there was no suggestion that foreign retaliatory acts would stem from California's taxation of domestic parent corporations (*id.* at 195), the Court concluded that California's tax as applied to members of domestic multinational corporations did not seriously threaten the foreign policy of the United States and thus did not violate the Commerce Clause. The Court, however,

[8] At the time *Container Corp.* was considered by the Court, there was another case (*Chicago Bridge & Iron Co.* v. *Caterpillar Tractor Co.*, No. 81-349) before the Court that presented virtually the same issue. The United States had submitted an amicus brief and participated in the oral argument in *Chicago Bridge*, taking the position that a similar Illinois tax involving a domestic corporation with foreign subsidiaries violated the Commerce Clause. After argument, the Court ordered *Chicago Bridge* carried over to the next Term, but did not schedule that case for reargument. Instead, it scheduled and heard argument in *Container Corp.* The Members of the Court disagreed as to what position the United States took with respect to *Container Corp.* See 463 U.S. at 195-196 & n.33; *id.* at 204 (Powell, J., dissenting).

recognized that the result may be different when the "incidence of the tax" (*ibid.*) falls on a foreign-controlled corporation. See *id.* at 188. The Court therefore expressly reserved judgment as to whether the tax would be constitutional as applied to members of a foreign-controlled corporate group. *Id.* at 189 n.26.

When, as in the present case, the State applies its worldwide combined reporting method to compute the state income tax of members of a foreign unitary corporate group, application of the tax creates an impediment in the relations of the United States with its trading partners and implicates foreign commerce concerns that are the exclusive province of the federal government. As this Court recognized in *Container Corp.*, 463 U.S. at 184-193, the arm's-length standard is the international norm for allocating income among controlled corporations across international boundaries and the method used by the United States for allocating income for federal income tax purposes. The method used by California is at odds with this accepted international practice. California's use of its inconsistent method of taxation has created serious tensions in the federal government's conduct of commercial relations with its trading partners and led to the enactment of retaliatory legislation (Pet. App. F44-F47). See p. 5, *supra*. California's application of its worldwide combined reporting method of taxation to compute the income tax of members of foreign-controlled unitary corporate groups violates the Commerce Clause under this Court's analysis in *Container Corp.* because California's unilateral action departs from an accepted international practice to which the United States adheres and prevents the United States from speaking with one voice on this sensitive and im-

portant matter of foreign commercial relations. See 463 U.S. at 185-189, 193-196.

2. The California Supreme Court did not test California's method of apportioning income in this case under the analysis set forth in *Container Corp.* because the court concluded (Pet. App. A39) that *Wardair Canada Inc.* v. *Florida Department of Revenue* imposed a new, preliminary hurdle to the taxpayer's argument. *Wardair* involved a challenge by a Canadian-based international air carrier to a state sales tax on fuel purchased in Florida for flights operating between Florida and Canada. The Court found "no threat of multiple international taxation * * * since the tax [was] imposed only upon * * * a discrete transaction which occurs within one national jurisdiction only" (477 U.S. at 9). Nor did the Court find any evidence that imposition of the sales tax in that case violated any international norm. *Id.* at 10. To the contrary, the Court concluded that numerous bilateral agreements to which the United States was a party were "understood * * * to permit this sort of taxation" and therefore "show that the Federal Government has affirmatively decided to permit the States to impose these sales taxes on aviation fuel." *Id.* at 12. Finding such "affirmative[]" approval of the state tax, the Court found "no need * * * to consider * * * whether, in the absence of these international agreements, the Foreign Commerce Clause would invalidate Florida's tax." *Id.* at 13.

California claims that this case is like *Wardair* because the United States is a party to numerous bilateral tax treaties that set forth agreements with respect to national-level taxation but do not address state or sub-national taxation (Pet. App. A34). Cali-

fornia relies specifically on the history of the 1975 tax convention between the United States and the United Kingdom (*id.* at A30-A31). As originally presented to the Senate for advice and consent to ratification, that treaty contained a provision (Article 9(4)) that required sub-national taxation to be consistent with the arm's length standard. See Convention Between United States and United Kingdom for Avoidance of Double Taxation, Dec. 31, 1975, 31 U.S.T. 5670, 5677, T.I.A.S. No. 9682. Although a majority of the Senate voted in favor of the treaty, less than the required two-thirds of the votes were obtained for ratification. 124 Cong. Rec. 18,669-18,670 (1978). In a subsequent vote, however, the treaty was approved subject to a reservation that Article 9(4)) would not apply "to any political subdivision or local authority of the United States" (*id.* at 18,416). See *id.* at 19,076. The California Supreme Court concluded from this history (Pet. App. A29-A30) that the Senate's action represents "affirmative" approval of the California tax under the analysis of this Court in *Wardair*.

The contrasts between this case and *Wardair* are striking. In *Wardair*, the Court found that numerous treaties had been made that were "understood" by the participants "to permit" state sales taxation to proceed. 477 U.S. at 12. That "understanding" was supported by the fact that there was no international norm precluding that type of state taxation. *Id.* at 10-11. In this case, by contrast, there is a well-established international practice precluding the State's contrary tax system,- a practice that the Executive has steadfastly honored and that a majority of the Senate voted to implement. Far from representing acquiescence through silence, this his-

tory of Executive and Senate action reflects the thoroughly national character of this issue and the need for federal-level, rather than state-level, disposition of the matter.

Unless this Court concludes that a minority of the Senate can determine the "affirmative" policy of the federal government, it cannot conclude that Senate action on federal tax treaties exhausts the scope of the national power to regulate foreign commerce. The Commerce Clause recognizes that there are matters affecting our foreign commercial relations that inherently require a national solution so that the United States may speak with one voice in its dealings with other Nations. That Congress has not yet crafted a solution to the problem does not mean that the choice of solutions has been left to the separate action of the several States. See *Container Corp.* v. *Franchise Tax Board*, 463 U.S. at 194.[9]

This Court's resolution of the question presented in this case is of great importance because the analy-

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[9] In *Container Corp.*, the Court reviewed much of the same treaty history and legislative proposals considered by the California Supreme Court in this case. See 463 U.S. at 196-197. The Court noted that Congress has "long debated, but has not enacted, legislation designed to regulate state taxation of income." *Id.* at 197 (quoting *Mobil Oil Corp.* v. *Commissioner*, 445 U.S. 425, 448 (1980)). As a result, the Court concluded that there was no "explicit directive" (463 U.S. at 197) limiting the State's ability to assess the tax at issue in *Container Corp.* That conclusion, however, did not remove the necessity of also considering whether the State's tax was unconstitutional because it would interfere with the conduct of foreign relations and prevent the federal government from speaking with one voice in the regulation of foreign commerce. See *id.* at 194-196. To the contrary, the Court made clear that *both* inquiries were necessary. See *ibid.*

sis applied by the California Supreme Court threatens broad impact on the constitutional allocation of authority to the federal government to regulate foreign commerce. Treaties often may stop short of addressing all aspects of commercial relations. Congress may also decline to enact legislative proposals disposing of similar problems. The fact that treaties and legislation have not provided a binding solution does not mean that the States are empowered independently to resolve politically sensitive matters affecting our international commercial relations.

CONCLUSION

If the Court concludes that it has jurisdiction (see Pet. 26-28), the petition for a writ of certiorari should be granted.

Respectfully submitted.

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BRIEF OF THE GOVERNMENT OF THE UNITED KINGDOM AS AMICUS CURIAE SUPPORTING PETITIONER

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BRIEF OF THE GOVERNMENT OF THE UNITED KINGDOM AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF AMICUS CURIAE

The issue before this Court is the constitutionality of Respondent Franchise Tax Board's application of worldwide combined reporting ("WWCR") to Barclays Bank of California ("BARCAL"), a domestic corporation with a United Kingdom parent, and Barclays Bank International, Limited ("BBI"), a United Kingdom corporation with a United Kingdom parent and foreign subsidiaries. BARCAL and BBI are members of but one of the many United Kingdom based corporate groups adversely affected by Respondent's isolated insistence upon the use of WWCR.

The United Kingdom and the United States have long subscribed to an international tax policy including the globally accepted arm's length separate accounting ("AL/SA") standard for allocating profits of multinational corporations between nations. Respondent's use of WWCR, in contradiction to the established international tax policy, has disrupted, and continues to disrupt, trading and investment relations between the two countries.

The Government of the United Kingdom ("the United Kingdom") and the United States Federal Government have traditionally cooperated to discuss and resolve matters of mutual concern generally, and tax matters specifically. The decision of the Supreme Court of the State of California below places in question future negotiations between the United Kingdom and the United States.

The United Kingdom hereby submits this brief *amicus curiae* in support of Petitioner.[1]

SUMMARY OF ARGUMENT

Respondent's application of WWCR to BARCAL and BBI, and other members of United Kingdom based multicorporate groups, is of grave concern to the United Kingdom. Such application is contradictory to the international tax policy established by the United Kingdom, the United States, and their trading partners. The use of WWCR subjects corporations like BARCAL and BBI to double taxation and disrupts trade between the United Kingdom and the United States. Respondent applies WWCR to income earned outside the United States without any provision for taxes assessed in the jurisdiction in which the income was earned.

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[1] Petitioner is successor in interest to Barclays Bank International, Limited and has assumed the interest of Barclays Bank of California for present tax matters and claims for refund.

Petitioner and Respondent have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

The United Kingdom cannot negotiate with California to avoid the extraterritorial results of WWCR. The United Kingdom must communicate with the United States Federal Government. The lower court decision places in doubt the power and authority of the Federal Government to participate in future discussion and resolution of treaty difficulties.

Respondent's use of WWCR results in California taxing foreign commerce. This Court has recognized that such taxation implicates matters of concern to the entire United States and has held that the Constitution of the United States, Foreign Commerce Clause of Article I, Section 8, clause 3, requires extensive constitutional scrutiny of such taxation.

This appeal presents an issue upon which this Court has previously reserved opinion: the constitutionality of Respondent's application of WWCR to a domestic corporation with a foreign parent, and a foreign parent with either a foreign parent or foreign subsidiaries. In its decision in which determination of that question was reserved,[2] this Court indicated a number of significant factors not presented by the application of WWCR to a domestic parent corporation with foreign subsidiaries.

All of those factors are present here: (1) WWCR is being applied to a foreign entity and its subsidiary; (2) such application is a matter of international, rather than domestic concern; (3) the Solicitor General of the United States has filed *amicus curiae* briefs in support of BARCAL and BBI at every court level; (4) the United States Federal Government has made clear its tax policy for domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is AL/SA and that tax policy is threatened

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[2] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

by Respondent's use of WWCR; (5) the trading partners of the United States are offended; and (6) the United Kingdom has enacted retaliatory legislation.

ARGUMENT

I. RESPONDENT'S USE OF WORLDWIDE COMBINED REPORTING IS OF GRAVE CONCERN TO THE UNITED KINGDOM.

The United Kingdom, the United States, and their trading partners avoid double taxation of their corporate citizens through the use of AL/SA. The requirement for AL/SA has been contained in every tax treaty to which the United Kingdom, the United States, and their trading partners, have been, or are now, a party.[3] Under AL/SA, corporations are subject to tax solely by the jurisdiction in which they operate and only on that portion of their income attributable to the business carried on in that jurisdiction. Profits are subsequently taxable when distributed as dividends in those jurisdictions where the dividends are received for tax purposes.

Under AL/SA, the income of each member of a corporate group is computed by separate accounting on the basis that each member of the group must deal with other members as if they were wholly separate entities owned by unrelated interests. Profitable corporations are subject to tax where the profits are made, and the less profitable or unprofitable subsidiaries pay less or no tax in the jurisdictions where they conduct business.

This Court has recognized that WWCR is a "serious divergence" from the internationally accepted AL/SA.[4]

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[3] For example: 1975 Income Tax Convention With the United Kingdom of Great Britain, and Northern Ireland, December 31, 1975, T.I.A.S. No. 9682.

[4] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 187 (1983).

In fact, no nation and no other nation's local political subdivisions use WWCR. Using WWCR, Respondent rejects the international corporate taxation principles of AL/SA and treats separate corporations—foreign and domestic—that are part of a multi-corporate group as one, and subjects all the worldwide income of the international corporate group to tax as one "unitary" corporation. It apportions the group's combined income between California and the rest of the world on the basis of an arbitrary formula composed of the ratio of payroll, sales, and property of the combined corporate group in California compared to the world. Moreover, Respondent combines the income without regard to whether such income is taxable under the Internal Revenue Code or applicable treaty, and without regard to the fact that income has been attributed to and taxed in foreign jurisdictions, under long-standing and well-recognized procedures established in international law. The United Kingdom has repeatedly objected to the extra-territorial results of WWCR.[5] The text of the most recent demarche, Note No. 91 from the United Kingdom to the United States Department of State, 22 July 1992, is contained in the appendix to this brief.

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[5] For example: Note No. 51 from United Kingdom Embassy to the United States Department of State, 3 March 1980; Demarche No. 211 from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, 30 October 1981; Demarche No. 83 from the United Kingdom Embassy, 18 May 1982; 12 July 1983 Letter of United Kingdom Chancellor of the Exchequer Nigel Lawson to Secretary of the Treasury of the United States Donald T. Regan; 22 June and 8 December 1991 Letters from United Kingdom Chancellor of the Exchequer Norman Lamont to Secretary of the Treasury of the United States Nicholas F. Brady; Note No. 91 from the United Kingdom to the United States Department of State, 22 July 1992. The United Kingdom has also participated in the numerous official expressions of opposition to Respondent's use of WCR submitted by demarche to the United States by the Member States of the European Communities from 19 March 1980 through 22 July 1992.

Respondent's insistence on its right to apply an isolated method of income allocation to BARCAL and BBI, contrary to the internationally accepted standard, is equal to a claim that California has the status of a nation in the international tax area and that the international community would accept a single nation having a contradictory system of income allocation. Neither can be the case. As this Court made clear in *Japan Air Lines, Ltd. v. County of Los Angeles*:

> California, by its unilateral act, cannot be permitted to place these impediments before the Nation's conduct of its foreign relations and its foreign trade.[6]

Additionally, as this Court has recognized, California is in no position to negotiate with the United Kingdom or other foreign governments, and neither the tax treaties nor federal law provides a mechanism by which the United States Federal Government could negotiate double taxation arising out of state tax systems.[7]

The United Kingdom, and other trading partners of the United States, must rely on the power and authority of the United States Executive Branch to speak for the nation. The lower court decision calls into question that power and authority. It would establish the principle that unless and until the United States Congress acts to limit a taxing state, it is free to tax as it pleases. The United Kingdom and the United States cannot continue their efforts to harmonize tax systems and manage the difficult problems of double taxation under such principle.

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[6] 441 U.S. 434, 453 (1979).

[7] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 193 (1983).

II. WHEN A STATE SEEKS TO TAX FOREIGN COMMERCE, THE FOREIGN COMMERCE CLAUSE OF ARTICLE I, SECTION 8, CLAUSE 3 OF THE CONSTITUTION OF THE UNITED STATES REQUIRES EXTENSIVE CONSTITUTIONAL SCRUTINY.

This Court has acknowledged that WWRC is a "serious divergence" from AL/SA, the method adopted by foreign taxing authorities "consistent with accepted international practice." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 187 (1983). It has also recognized that if a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate and such retaliation of necessity would be directed not just at the taxing state, but the United States.[8] Thus, the constitutional prohibition against state taxation of foreign commerce is broader than the protection afforded to interstate business within the United States and requires additional scrutiny by this Court. *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445-446 (1979); *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 185 (1983); *Kraft General Foods, Inc., Petitioner v. Iowa Department of Revenue and Finance*, 60 LW 4583, 4584 (6-16-92).

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[8] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 450 (1979) citing *Chy Lung v. Freeman*, 92 U.S. 275, 279, 23 L.Ed. 550 (1876) (invalidating California's bond requirement for Chinese immigrants):

> "[I]f this plaintiff and her twenty companions had been subjects of the Queen of Great Britain, can any one doubt that this matter would have been the subject of international inquiry? Upon whom would such a claim be made? Not upon the State of California; for, by our Constitution, she can hold no exterior relations with other nations. It would be made upon the government of the United States. If that government should get into difficulty which would lead to war, or to suspension of intercourse, would California alone suffer, or all the nation?"

III. THIS APPEAL CONTAINS ALL THE ELEMENTS THIS COURT HAS DETERMINED AS NECESSARY TO DETERMINE THE QUESTION ON WHICH IT HAS PREVIOUSLY RESERVED OPINION: THE CONSTITUTIONALITY OF RESPONDENT'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO DOMESTIC CORPORATIONS WITH FOREIGN PARENTS AND FOREIGN CORPORATIONS WITH EITHER FOREIGN PARENTS OR FOREIGN SUBSIDIARIES.

Container involved Respondent's application of WWCR to a domestic parent corporation with overseas subsidiaries. The determination of the issue presented by Petitioner's petition, the constitutionality of WWCR when applied to domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, was reserved.[9]

This appeal, as opposed to *Container*, involves a domestic corporation with a foreign parent, and a foreign parent with a foreign parent and subsidiaries. Here, there is: (1) an "automatic asymmetry" between Respondent's use of WWCR and the acknowledged international tax structure; (2) the tax is imposed on a foreign entity and its subsidiary; and (3) it is a matter of international concern because the United Kingdom and other nations are interested in insuring equitable taxation of their corporations.

The serious threat to the foreign policy of the United States posed by Respondent's use of WWCR is supported by factors also not present in *Container*. Here the Solicitor General has filed amicus curiae briefs at every court level in support of BARCAL and BBI that make clear the Federal Government's view that WWCR threatens the United States' foreign policy and there can be no question that the taxation policy of the United States for domestic corporations with foreign parents,

[9] 463 U.S. 159, 188 n. 26, 196 n. 32 (1983).

or foreign corporations with either foreign parents or foreign subsidiaries, is AL/SA.[10]

The most obvious foreign policy implication a state tax can have is to offend the United States' trading partners and lead them to retaliate.[11] Proof of that implication is also present here. All of the major trading partners of the United States have repeatedly expressed their offense at Respondent's application of WWCR to multi-corporate groups to their corporate citizens.[12] The United Kingdom, after patiently awaiting the cessation of that use for over a decade, has enacted retaliatory legislation. Section 54 of and Schedule 13 to the Finance Act of 1985 (now reenacted as Section 812-815 of the Income and Corporations Taxes Act 1988) gives the United Kingdom the authority to retaliate by depriving American parent corporations, with a presence in states that use WWCR, of the shareholders' tax credit which the United Kingdom gives on dividends paid by their subsidiaries in the United Kingdom.[13]

Petitioner's petition brings to this Court an issue upon which it previously reserved its opinion—the significance of domestic corporations with foreign parents, or foreign

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[10] See for example: November 8, 1985 Statement of President Ronald Reagan, 45 *Weekly Compilation of Presidential Documents* 1368; January 30, 1986 Letter from United States Secretary of State George P. Shultz to the Governor of California; and March 5, 1986 Letter of United States Secretary of the Treasury James A. Baker, III to Representative Daniel Rostenkowski, Chairman of the House of Representatives Committee on Ways and Means.

[11] *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 194 (1983).

[12] See for example: Brief of the Member States of the European Communities and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland as *amicus curiae* supporting Petitioners filed herein.

[13] House of Commons Official Report, *Parliamentary Debates* (Hansard), 1036 (9 July 1985) (statement of John Moore).

corporations with either foreign parents or foreign subsidiaries, in assessing the unconstitutionality of Respondent's use of WWCR. The United Kingdom believes this Court would not have left the issue unresolved in *Container*, if it had any doubt that domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, present additional considerations deserving extensive constitutional scrutiny. The United Kingdom is anxious to have the issue resolved before more harm is done to United Kingdom corporations and to United Kingdom-United States relations.

CONCLUSION

For these reasons, Petitioner's petition should be granted.

Respectfully submitted,

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Counsel for the Government of the United Kingdom as Amicus Curiae

Dated: August 27, 1992

APPENDIX

NOTE NO.: 91

The British Embassy present their compliments to the Department of State and have the honour to refer to the decision of the California Supreme Court in the case of *Barclays Bank v. California Franchise Tax Board.* The Embassy wish to convey their disappointment with the decision of the Californian Supreme Court to uphold the State of California's imposition of the worldwide unitary basis of taxation. In the Embassy's view, there are important matters not fully taken into account by the California Supreme Court and immediate review of the decision by the U.S. Supreme Court is essential.

The Embassy further have the honour to note that the California Supreme Court did not refer to the paramount interests of both the United States and British governments and those other governments which comprise the major trading partners of the United States in maintaining the internationally accepted arm's length separate entity standard for allocating profits of multinational corporations between nations. The worldwide unitary basis of taxation imposed by California is contrary to and incompatible with those standards. California's use of this method interferes with the joint efforts of our joint efforts of Britain and the United States to harmonize tax systems and to manage the difficult problems of double taxation.

The Embassy are further concerned that the California Supreme Court considers that the United States Congress has adopted a policy permitting the application of the unitary basis of taxation by the states of the United States to foreign-owned multinational corporations; that the British Government and the United States Government had agreed to that policy choice by entering into the US/UK Double Taxation Treaty with a reservation

to a provision in that Treaty barring such use, and that the British Parliament was acceding to the "demands" of the United States Congress in ratifying the Treaty.

A majority of the United States Senate (though not a two-thirds majority) favoured inclusion of a provision barring use of such taxation method in the Treaty. It is difficult to see how a policy favouring use of such method could arise from a reservation leaving this issue unaddressed. The British Government and the British Parliament have not accepted the State of California's use of the unitary method, a point which has been made clear in a number of communications, notably in letters dated 22 June and 8 December 1991 from the British Chancellor of the Exchequer, the Rt Hon Norman Lamont MP, to the U.S. Secretary of the Treasury. The Financial Secretary to the Treasury told the House of Commons on 14 May 1992 that the retaliatory legislation enacted in the United Kingdom in 1985 is "not a mere ornament on the statute book". There have been repeated assurances by members of Congress that the problem would be solved.

The California Supreme Court's characterisation of the United States Government's opposition as mere "Executive Branch aspirations" and its further statement that the U.S. Government has expressed an "eloquent silence" on worldwide unitary taxation belittles the extensive discussions between the British and the United States governments on the impropriety of that taxation method. The implications of these pronouncements by the California Court for future discussions and resolutions of treaty difficulties are a matter of great concern. The British Government understood that the assurances of the Executive Branch were the assurances of the Government of the United States and could therefore be relied upon. The California Supreme Court appears to call into question the capacity of the US Executive, led by the President, to deal with the British Government by imply-

ing that Congress is the only branch of U.S. Government capable of setting policy in this area.

In the 1991 joint study by the United States Department of Treasury and the British Inland Revenue it was agreed that the best means of achieving resolution of this matter was in the Supreme Court of the United States. Accordingly, it is essential that the United States Solicitor General should support the Barclays petition for certiorari before the United States Supreme Court and continue its amicus curiae support. The British Government believes immediate review of the California Supreme Court decision is essential to avoid an outcome that could risk damaging relations between the United States and the United Kingdom.

The British Embassy avail themselves of this opportunity to renew to the Department of State the assurances of their highest consideration.

[British Embassy Seal]

British Embassy
Washington D.C.

22 July 1992

Supreme Court, U.S.
FILED
AUG 28 1992
OFFICE OF THE CLERK

No. 92-212

IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1992

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD, AN AGENCY OF THE STATE OF CALIFORNIA,

Respondent.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF FOR ORGANIZATION FOR INTERNATIONAL INVESTMENT INC. AND UNION OF INDUSTRIAL AND EMPLOYER'S CONFEDERATIONS OF EUROPE AS *AMICI CURIAE* IN SUPPORT OF *CERTIORARI*

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INTEREST OF AMICI CURIAE

The Organization for International Investment Inc. ("OFII") is a non-profit corporation the members of which are United States subsidiaries of foreign

shareholders.[1] The Union of Industrial and Employer's Confederations of Europe ("UNICE") is recognized as the official spokesman for European Business and industry vis-a-vis the European Economic Community and other European institutions.[2]

OFII members are domestic companies engaged in manufacturing, distributing goods, and performing services within the United States. OFII members export manufactured and processed goods and import various articles. OFII represents members' interests in matters of federal and State taxation and seeks legislative and judicial solutions to problems affecting economic interests of members. OFII members have a direct interest in the international aspects of the tax issues presented by this case. Similarly to the petitioners, OFII members bear an increased and discriminatory tax burden under California law. OFII members are treated as unitary with their foreign affiliated companies and are obliged to pay California taxes on foreign source income of companies that do not do business anywhere in the United States. California's scheme of worldwide taxation creates a substantial impediment to international commerce and to investment in the United States by foreign persons.

The member federations of UNICE are the official representatives of all sectors of business and industry in their respective nations. UNICE comprises thirty-two member federations from twenty-two European nations including all European Community and European Free Trade Association nations. UNICE's permanent secretariat is in Brussels, Belgium. An important objective of UNICE is to promote international commerce and investment by eliminating international double taxation.

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1. A list of OFII members is appended (Appendix I). Neither the petitioner nor any of its subsidiaries and affiliates are members of OFII.

2. A list of UNICE organizations is appended (Appendix II). UNICE is the Union's French acronym.

UNICE views California's taxation of foreign (to the U.S.) source income as a direct impediment to the flow of capital and intellectual property between the United States and the nations UNICE represents. UNICE is particularly concerned with the extraterritorial reach of California's unique tax method and with the fact that its worldwide application is entirely inconsistent with the longstanding, internationally agreed, arm's length standard.

SUMMARY OF ARGUMENT

This case involves the power of the State of California under the United States Constitution to contravene federal tax policy in foreign commerce. The federal government has adopted the international standard method of arm's length, separate entity accounting for division of taxable income among nations. California has adopted a worldwide, combined income apportionment method that cannot be reconciled with the federal and international method. The United States cannot conduct a coherent foreign economic policy in the face of these disparate and incompatible methods. The issue is which government's policy shall prevail.

This issue is ready for decision in this case.[3] Two years ago, this Court heard a case on the standing of foreign corporations to challenge the constitutionality of California's tax method.[4] Respondent, Franchise Tax Board, petitioner from an adverse United States Court of Appeals decision, argued that California courts provided the appropriate fora for hearing the issue of a State's constitutional power to tax foreign commerce. The Board's counsel earnestly contended that this Court should not presume that State courts would decline to

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3. The precise issue presented by this case was expressly left open for decision in an appropriate case by this Court in *Container Corp. v Franchise Tax Board,* 463 U.S. 159, 189, n. 26 (1983).

4. *Franchise Tax Board v Alcan Aluminium, Ltd.,* 493 U.S. 331 (1990).

follow this Court's mandates and refuse to consider the Foreign Commerce Clause issue. Counsel twice referred to this [*Barclays*] case as *the* State court case that best presented the issue.[5] Notwithstanding respondent's earlier contentions, the California Supreme Court has now declined to consider the Foreign Commerce Clause issue in the light of prior decisions of this Court.

Overruling the California District Court of Appeal which did consider the issue, the California Supreme Court substituted a novel analysis that elevates Congressional inaction to Congressional mandate.[6] Under this California approach, any State may establish policy affecting foreign commerce of the United States and even contravene federal foreign policy until told to stop by Congress. The California Supreme Court's decision ignores this Court's precedents and undermines federal policy in the sensitive area of foreign relations of the United States. This Court is now urged to hear this case to settle this issue finally.

ARGUMENT

A. USE OF WORLDWIDE COMBINED INCOME REPORTING BY A STATE IMPAIRS THE FEDERAL GOVERNMENT'S ABILITY TO CONDUCT FOREIGN RELATIONS.

The United States Government adopted the arm's length method many years ago[7] as its standard for allocating income among commonly controlled corporations doing business in more than one nation. This

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5. Excerpts from the transcript of oral argument in which these contentions were made are appended (Appendix III).

6. This was done on the basis of the California Supreme Court's reading of *Wardair Canada Inc. v Florida Dept. of Revenue* 477 U.S. 1 (1986), which this Court apparently did not find relevant in *Alcan*.

7. Foreign Investors Tax Act, Tit. I, P.L. 89-809, 89th Cong. 2d Sess. (1966), 80 Stat. 1539.

method is reflected in the Internal Revenue Code and is embodied in bilateral tax treaties to which the United States is a party.[8] The Unites States has, in fact, strongly advocated to other nations that the arm's length method is the most appropriate for allocating transnational income to a taxing nation.[9]

It is incontrovertible that worldwide, combined, income reporting for tax purposes is not compatible with the arm's-length method. The United States cannot seriously argue for a uniform standard to divide income among nations and expect other nations to abide by that standard if it is unenforceable even within the United States. The intrusion of worldwide combined reporting ". . . impair[s] the ability of the federal government to carry out its tax and investment policy in the international area" and "has seriously complicated [the United States'] economic relations with many of our closest allies."[10] Its use has been a source of conflict among nations that has already led to harm to the United States as a whole.[11] The purpose of a standard is to secure uniform treatment of United States business abroad as part of United States economic policy. The *quid pro quo* is uniform treatment of foreign business in the United States. This is not possible if California adheres to an incompatible standard.

The precise legal issue presented by this case is whether United States foreign policy as conducted by the Executive Branch, together with Congressional assent to that policy in the form of enabling legislation and

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8. Letter of Secretary of State Schultz to Governor Deukmejian, Petitioner's Appendix, F-44.

9. *Ibid.*

10. Schultz letter, *id.* at F-46

11. Letter of 30 June 1989, on behalf of the European Community, delivered to the Secretary of State by the Spanish Ambassador, reproduced and annexed as Appendix IV.

treaty ratification, is sufficient to invoke the protection of the Foreign Commerce Clause for that foreign policy.[12]

B. THIS CASE IS RIPE FOR IMMEDIATE DECISION. ITS RECORD CONTAINS ALL LEGAL AND FACTUAL MATTERS NEEDED TO RESOLVE THE CONSTITUTIONAL ISSUE IN FULLY DEVELOPED FORM AFTER TRIAL AND JUDGMENT ON THE MERITS WITH COMPLETE APPELLATE REVIEW BY STATE COURTS.

In 1984, two foreign corporations, Alcan Aluminium, Ltd. (Alcan) and Imperial Chemical Industries PLC (ICI), brought suit in United States District Court challenging California's authority under the Foreign Commerce Clause to impose franchise taxes based on worldwide combined reporting on the plaintiffs' domestic subsidiaries. The District Court dismissed the case on grounds that Alcan and Imperial as shareholders of the taxpayers, lacked standing to challenge tax liabilities of their subsidiaries. The United States Court of Appeals (Seventh Circuit) reversed and remanded for consideration of the merits of the constitutional issue. This Court granted *certiorari*.[13]

In brief and upon oral argument to this Court, the Franchise Tax Board vigorously contended that the Federal Tax Injunction Act, 28 U.S.C. § 1341, precluded a decision on the merits of the cases because the California courts provided a "plain, speedy and efficient remedy."[14] The Franchise Tax Board stated that any

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12. This is frequently referred to as the "dormant" Commerce Clause issue. The *Alcan* opinion, 493 U.S. at pp. 334-335, specifically referred to *Container Corp. v Franchise Tax Board,* 463 U.S. 159 (1983) and *Japan Line Ltd. v Los Angeles County,* 441 U.S. 434 (1979) as the controlling authorities.

13. *Franchise Tax Board v Alcan Aluminium, Ltd.,* 493 U.S. 331 (1990).

14. Franchise Tax Board's Petition for writ of Certiorari in *Alcan, supra* n.12, at pp. 20-23; Brief for the Petitioners, at pp. 41-48; Reply Brief of Petitioners at pp. 21-28.

attack on worldwide combined reporting must first be brought in the California courts and twice mentioned that this case, *Barclays*, was already pending there.[15] The Board argued that *Barclays* squarely presented the same Foreign Commerce Clause issues that Alcan and ICI were asserting. The Board also argued to this Court:[16]

> It cannot be presumed that, when confronted with a tax case involving a multinational enterprise, a state court will decline to follow the mandate of this Court and refuse to consider the issues raised by the Foreign Commerce Clause, i.e., whether the disputed tax creates an impermissible risk of double taxation or violates the "one voice" standard.

The California Supreme Court has, nevertheless, done precisely what the Franchise Tax Board said this Court should not presume that a State court would do – namely, decline to follow the mandate of this Court and refuse to consider the Foreign Commerce Clause issues raised by this case (*Barclays*). The California Court chose not to follow the dormant Commerce Clause analysis developed by this Court in *Container Corp.* and *Japan Line.*[17] The California court, rather, chose to read *Wardair Canada Inc.*[18] as a blanket permit removing the State's tax method from scrutiny in the absence of Congressional action expressly forbidding use of the method. This clearly contravenes the views expressed by this Court last term in striking down a State tax exclusively levied on foreign dividends.[19]

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15. Reply Brief of Petitioners on Writ of Certiorari, *Alcan*, pp. 21-28.

16. Petitioner's Reply Brief, *Alcan*, p.23.

17. *Supra,* n. 12.

18. *Supra,* n. 6.

19. *Kraft General Foods v Iowa,* ____ U.S. ____, 60 LW 4582, 4584 (#90-1918, 1992). The dissent, moreover, noted that the case did *not* involve a foreign entity and that the Executive Branch actually *supported* the State's power to levy the tax. It may be surmised, therefore, that both the majority and the dissent would have viewed the instant case more favorably to Petitioners.

This case now comes to this Court after eight years of litigation on these Foreign Commerce Clause issues in the California court system.[20] The record in this case was fully developed at trial, and the Foreign Commerce Clause issues were carefully considered and decided by the California Superior Court and the California Court of Appeal before reaching the California Supreme Court. The decision of the California Supreme Court is final on the Foreign Commerce Clause issue notwithstanding that court's remand of the separate Due Process claim that the Court of Appeal did not decide. The California Supreme Court has already begun to apply its decision to other litigants, and other California courts are bound to follows its precedent.[21]

It may be anticipated that the Respondent will again urge this Court to decline to review California's application of worldwide combined reporting in this case and to wait for more State proceedings or for another case.[22] The argument this time will be that the *Barclays* decision is not final because the Court of Appeal did not initially decide the Due Process issue.

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20. Five of those years were spent in the appellate process. The petitioners herein filed their complaint in Superior Court on 30 November 1984. The trial court filed its decision on 20 August 1987.

21. Order of the California Supreme Court to vacate and modify the opinion of the California Court of Appeal in *Colgate-Palmolive Co., Inc. v Franchise Tax Board* (18 June 1992).

22. The respondent, Franchise Tax Board, has managed to avoid a decision on the merits of this foreign commerce issue for more than ten years in both State and federal courts. See, *e.g., Capitol – Industries EMI, Inc. v Bennett,* 681 F.2d 1107 (9th Cir.), *cert. denied,* 459 U.S. 1087 (1982); *Shell Petroleum N.V. v Graves,* 570 F. Supp. 58 (N.D. Cal.), *aff'd* 709 F.2d 593 (9th Cir.), *cert. denied sub nom. Shell Petroleum N.V. v Franchetti,* 464 U.S. 1012 (1983); *Alcan Aluminium, supra,* n.4. This is the first case in which a foreign parent corporation, itself, has been able to claim standing in California courts as a "taxpayer." The California Supreme Court has declined to hear previous cases involving State and local taxation of foreign commerce. Both *Japan Line* and *Container Corp.* (*supra,* n.12) were appeals from lower California courts.

The Due Process issue is legally and factually severable from the Foreign Commerce Clause issue. The Due Process issue concerns a California regulation governing filing of returns by taxpayers subject to worldwide combined reporting and the fact that literal compliance with that regulation appears to be impossible. However that issue may finally be resolved, the California court system is finished with the Foreign Commerce Clause question.[23] That question will not be revisited by California whatever the outcome of the Due Process issue.[24]

The Foreign Commerce Clause issue presented by this case is too important to be delayed once again. Worldwide combined reporting continues to interfere with United States foreign policy, to offend the United States' trading partners, and to undercut important federal economic policies. The decision of the California Supreme Court is so patently inconsistent with this Court's prior decisions that it should not be allowed to cast a further shadow over the foreign relations and foreign commerce of the United States.

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23. The Respondent, the Franchise Tax Board, has required all taxpayers wishing to defer resolution of their administrative and court cases pending the outcome of *Barclays* to waive all issues other than the "one voice" Foreign Commerce Clause issue. Petitioner's Appendix, G-1. None of these taxpayers, consequently, can be affected by a decision on the Due Process issue. The Respondent clearly believes that only the Foreign Commerce issue is of importance in these cases.

24. The decision of the California court falls within the "fourth category" of cases meeting the finality requirement rescribed by this Court in *Cox Broadcasting Corp. v Cohn*, 420 U.S. 469, 482-85 (1975). The Foreign Commerce Clause issue has been finally decided in the State courts. Reversal of the State courts on this issue by this Court would preclude further litigation on any remaining issues in the case. Refusal by this Court to hear *Barclays* at this time would seriously erode federal policy and work a great hardship on the many other taxpayers whose cases are awaiting the outcome of the Foreign Commerce issue.

CONCLUSION

For the reasons stated, *amici curiae,* Organization For International Investment and Union of Industrial and Employer's Confederations of Europe urge this Court to grant the Petition for Certiorari.

Respectfully submitted,

James Merle Carter
(Counsel of Record)

28 August 1992

APPENDIX

APPENDIX I

ORGANIZATION FOR INTERNATIONAL INVESTMENT INC.
CORPORATE MEMBERS

AKZO AMERICA, INC.
ALCAN ALUMINUM CORPORATION
ALLIED LYONS NORTH AMERICA CORPORATION
ASEA BROWN BOVERI, INC.
BASF CORPORATION
BATUS INC.
BET SERVICES
BNFL INC.
BP AMERICA CORPORATION
BRITISH AEROSPACE, INC.
BTR, INC.
BUNGE CORPORATION
CIBA-GEIGY CORPORATION
E.C.C. INTERNATIONAL, INC.
FINA OIL & CHEMICAL CO.
FUJITSU AMERICA, INC.
GLAXO INC.
GRAND METROPOLITAN INCORPORATED
GUINNESS AMERICA, INC.
HANSON INDUSTRIES
HITACHI AMERICA, LTD.
HOECHST-CELANESE CORPORATION
HOFFMANN-LA ROCHE, INC.
ICI AMERICAS INC.
LAFARGE CORPORATION
LVMH MOET HENNESSY LOUIS VUITTON
MARINE MIDLAND BANK, N.A.
MATSUSHITA ELECTRIC CORPORATION OF AMERICA
NESTLE USA, INC.
NORTH AMERICAN PHILIPS CORPORATION
PEARSON INC.
PECHINEY CORPORATION
PILKINGTON HOLDINGS, INC.
REED PUBLISHING (USA) INC.

RHONE-POULENC
ROLEX WATCH, U.S.A., INC.
RTZ AMERICA
SANDOZ CORPORATION
S.G. WARBURG & CO. INC.
SIEMENS CORPORATION
SMITHKLINE BEECHAM
SONY CORPORATION OF AMERICA
SOUTHLAND CORPORATION
THOMSON CONSUMER ELECTRONICS, INC.
THORN EMI NORTH AMERICA HOLDING, INC.
TOYOTA MOTOR SALES, U.S.A., INC.
UNILEVER UNITED STATES, INC.
VOLVO OF NORTH AMERICA CORPORATION

APPENDIX II
UNICE MEMBERS

Federation des Entreprises de Belgique (Belgium)
Danish Employers' Confederation (Denmark)
Federation of Danish Industries (Denmark)
Conseil National du Patronat Français (France)
Bundesvereinigung der Deutschen Arbeitgeberverbände – BDA (Germany)
Bundesverband der Deutschen Industrie – EDI (Germany)
Federation of Greek Industries (Greece)
Confederazione of Irish Industry – CII (Ireland)
Federation of Irish Employers – FIE (Ireland)
Confederation Generale dell' Industria Italiana – CONFINDUSTRIA (Italy)
Federation des Industriels Luxembourgeois (Luxembourg)
Verbond van Nederlandse Ondernemingen – VNO (Netherlands)
Nederlands Christelijk Werkgeversverbond – NCW (Netherlands)
Confederacion Espanola de Organizaciones Empresariales – CEOE (Spain)
Associaçao Industrial Portuguesa – AIP (Portugal)
Confederaçao da Industria Portuguesa – CIP (Portugal)
Confederation of British Industry – CBI (United Kingdom)
Vereinigung Osterreichischer Industrieler – VOI (Austria)
Confederation of Finnish Industries (Finland)
Finnish Employers' Confederation (Finland)
Federation of Icelandic Industries (Iceland)
Confederation of Icelandic Employers (Iceland)
Confederation of Norwegian Business and Industry (Norway)
Swedish Employers' Confederation (Sweden)
Federation of Swedish Industries (Sweden)

"Vorort" de l'Union Suisse du Commerce et de l'Industrie (Switzerland)
Union Centrale des Associations Patrocales Suisses (Switzerland)
Turkish Industrialists' and Businessmen's Association – TUSIAD (Turkey)
Turkish Confederation of Employer Associations – TISK (Turkey)
Employers & Industrialists Federation Cyprus (Cyprus)
Malta Federation of Industry – MFOI (Malta)
Associazione Nazionale dell'Industria Sammarinese (San Marino)

APPENDIX III

Extract pages from Oral Argument of Franchise Tax Board in No. 88-1400
Franchise Tax Board v. Alcan Aluminium Limited
1 November 1989

issues. But once they were in the federal courts and were confronted with a Tax Injunction Act, then they said well, the Tax Injunction Act can't apply to us because we have no plain, speedy or efficient remedies in the state courts.

QUESTION: Do they?

MR. LADDISH: They do, in effect, have plain, speedy and efficient remedies.

QUESTION: How? How?

MR. LADDISH: Through the fact that they are the sole stockholders of the taxpayers in this –

QUESTION: You think that the domestic subsidiary can raise the issues for them?

MR. LADDISH: Certainly, Your Honor. The – the domestic subsidiaries are the taxpayers. They are the parties that have been assessed the tax. What's put in issue in the –

QUESTION: You think they can raise the foreign commerce clause issues, the domestic subsidiary can?

MR. LADDISH: It – it's only common sense that they can, and also it's, if you look to what is going on in the California courts right now –

QUESTION: You don't think you would be in there arguing against that?

MR. LADDISH: Excuse me?

QUESTION: In the – you wouldn't be arguing against that in the state courts?

MR. LADDISH: Currently there are cases pending in the California state courts where the issues are being raised by subsidiaries –

QUESTION: And what position is the state taking on those? Is the state saying fine, we're going to litigate those issues?

MR. LADDISH: The state is taking the issue, as to some of them, the state is taking a procedural defense that they did not raise them in the claims for refund. But in no case is the state claiming that the subsidiaries cannot raise those foreign commerce claims. And we – we would be unsuccessful if we did try to raise that, because –

QUESTION: And how about the claim that it costs more for the parent?

MR. LADDISH: Those claims are being fully litigated in – in the state courts. In one case, the Barclay's case, I believe that is one of the issues where we are claiming that they did not raise that in the – in the claim for refund.

QUESTION: Do you think under California state tax law that the state could take the position that it can tax the parent, that the parent's the taxpayer?

MR. LADDISH: Not under the California state law, Your Honor, in that the California –

QUESTION: Well, it reads broadly enough. I mean, you take the position you can tax all their income.

foreign commerce clause in the situation we are here, for the reasons that I stated before, they are not one and the same. Certainly there are statutes that create injuries, and if you violate that statute you are injured. And it would be very hard to separate out the standing injury from the — from the decision on the merits. But that is not the case today. If it is determined that they do not have standing here, that does not mean that that does away with all the arguments that they are making as far as it being invalid under the foreign commerce clause. The taxpayers can make that argument and, as pointed out by one of the amici supporting the Respondents today, there are — there is litigation in the California courts that are raising these issues now, and one of the litigants is a subsidiary and the other one is an intervening parent; but the ultimate parent is not a part of the litigation.

QUESTION: I understand from your adversary to say the Ninth Circuit has decided that these issues can't be raised.

MR. LADDISH: The Ninth Circuit has only decided that as to the — the Ninth Circuit first decided that there was no standing. But as to the Tax Injunction Act, the Ninth Circuit decided, in a rather mechanical version, that the control that the sole stockholder would have over its taxpayer should not be considered by the court as giving it an effective remedy in the California courts. It just said since they cannot proceed

in their own name –

QUESTION: Well, you're arguing that it is an effective remedy.

MR. LADDISH: Yes, I certainly am, Your Honor.

QUESTION: So you are arguing the Ninth Circuit is wrong, as well as the Seventh?

MR. LADDISH: On that, yes. Thank you very much.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Laddish. The case is submitted.

(Whereupon, at 1:52 p.m., the case in the above-entitled matter was submitted.)

[49]

APPENDIX IV

Letter From the European Community To The United States Government.

EL EMBAJADOR de ESPAÑA
WASHINGTON
June 30th, 1989

The Honorable
James A. Baker, III
Secretary of State
U.S. Department of State
Washington, D.C. 2520

Dear Sir:

The Member States of the European Community have noted that the United States Supreme Court is shortly to hear an appeal against the judgement of the Seventh Circuit Court of Appeals in Imperial Chemical Industries plc [sic] and Alcan Aluminium Limited v. California Franchise Tax Board.

The EC Member States consider this to be an appropriate opportunity to restate their opposition to the use of worldwide unitary tax by the State of California. They would urge the United States Government to confirm that, like the previous Administration they, too, are opposed to the use of worldwide unitary tax.

The views of the EC Member States on worldwide unitary tax are well known.* They consider that the imposition of this tax is inconsistent with the internationally accepted principles underlying the Tax Treatics and Friendship Treaties that individual Member States have entered into with the United States. Specifically, the use of the tax by the State of California:

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*Demarche of the EC Member States submitted to the U.S. Department of State; 19 March, 1980; 30 October, 1981; 29 June, 1982; 1 August, 1983; 23 September, 1983; 20 December, 1984; 8 August, 1985; 30 August, 1985.

i) contradicts the "arm's length" principal of allocating income of multi-national corporations between different national jurisdictions;

ii) may give rise to substantial double taxation;

iii) imposes a severe compliance burden by insisting on the restatement of accounts of different, but affiliated, corporations throughout the world even when they are not doing any business in California—accounts which were originally prepared to meet the specifications of the countries in which these corporations are resident;

iv) has perverse effects on the worldwide strategy of multi-national corporations (since, for example, a cost saving investment made in any country ouside the U.S., can increase the tax liability in Califronia, even if the California subsidiary is loss-making);

v) discriminates against companies doing business in California via subsidiaries, rather than through non-affiliated companies.

The EC Member States are strongly opposed to the attempt by California or any other State to impose taxation in income of foreign corporations arising outside the U.S.; to interfere with worldwide investment strategies, and to insist on burdensome compliance requirements on companies located outside the U.S.

EC Member States are aware that California has amended its legislation to allow multi-national companies to elect, on payment of a fee, to be taxed on a "water's edge", rather than worldwide unitary basis. However, since they are opposed to the use of worldwide unitary tax in principle, Member States cannot accept that it is right to insist on a fee as the price for electing to avoid worldwide unitary tax. Moreover, the process of making such an election involves substantial and unreasonable burdensome compliance costs.

The EC Member States, of course, support the case submitted by Imperial Chemical Industries and by Alcan Aluminium in the District Court and the Seventh Circuit Court of Appeal. They also very much endorse the *amicus* brief submitted by the U.S. in the District Court in ICI and Alcan v. California FTB. The EC Member States are aware that the issue currently before the Supreme Court is the question of the standing of the foreign parent companies to challenge the tax in the Federal courts, rather than the constitutionality of the tax itself. However, they believe the two issues to be inextricably interlinked. The EC Member States consider that worldwide unitary tax imposes an administrative and economic burden on foreign parent corporations and breaches the arm's length standard. Since the U.S. in its double taxation convention adheres to the internationally accepted arm's length principle, application of worldwide unitary tax by separate states of the U.S. prevents the U.S. from speaking with one voice when regulating commercial relations with foreign governments, and in the opinion of EC Member States is unconstitutional. The administrative and economic burden is imposed directly on foreign corporate parents and it is this constitutionally significant burden which creates standing for those foreign parents.

The Member States note and appreciate the U.S. Government's opposition to worldwide unitary tax. Given the importance of the present case before the Supreme Court, the Member States would urge the U.S. Government to reaffirm their commitment to the position taken by the previous Administration.

Sincerely,

/s/ Julian Santamaria

Julian Santamaria
Ambassador of Spain

Supreme Court, U.S.
FILED
AUG 31 1992
OFFICE OF THE CLERK

No. 92-212

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BARCLAYS BANK PLC,
Petitioner,

v.

FRANCHISE TAX BOARD,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of California

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association, which was originally organized in 1969 as an advisory committee to the Council of State Cham-

bers of Commerce. COST, which was separately incorporated January 1, 1992, has a membership of 372 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Virtually all COST member companies are engaged in business in the State of California, either directly or through subsidiary operations, and are subject to that State's corporate income tax. COST member companies include a substantial number of corporations that are owned by non-U.S. corporations. A significant number of COST member companies are engaged in business in jurisdictions outside the United States and would be subject to retaliatory actions by such countries should worldwide combined reporting be upheld. Therefore, COST clearly has an interest in the instant case, in which the constitutionality of California's imposition of worldwide reporting on foreign parent unitary groups is at issue.[1]

SUMMARY OF ARGUMENT

The State of California's imposition of worldwide combined reporting has been the subject of Foreign Commerce Clause challenges for over twenty years. Although this reporting method, as applied to domestic parent groups was upheld in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court explicitly reserved the specific question at issue in this case, that is, whether worldwide combined reporting as imposed on a foreign parent unitary group violates the Foreign Commerce Clause. 463 U.S. at 189, fn. 26. Not only does this

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[1] Worldwide combined reporting, the method used by California to apportion the income of multinational corporations, and the arm's length separate accounting method, which is used by the United States and its foreign trading partners to allocate such income, are explained by petitioner in its Petition for Writ of Certiorari, at page 5.

case raise the issue reserved by the Court in *Container*, it also presents certain facts that the Court emphasized as missing in *Container*. The tax at issue in this case falls on a foreign entity, 463 U.S. at 195, the Federal Government has filed *amicus* briefs during the litigation in the California courts expressing its opposition to worldwide combinued reporting, 463 U.S. at 195-196, and this Court no longer has to guess at the risk of retaliation by foreign nations, 463 U.S. at 194, as the offense to our foreign trading partners has been clearly expressed by the United Kingdom's enactment of retaliatory legislation. Thus, nine years after *Container*, this Court is finally presented with a fully developed opportunity to answer the question left open in that case.

Moreover, the decision of the California Supreme Court, holding that "governmental silence" evidences Federal approval of worldwide combined reporting (or any other state policy implicating foreign relations) sets a precedent that is contrary to this Court's Foreign Commerce Clause jurisprudence as developed in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), *Container*, *supra*, and *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986).

Because of the implications of the decision of the California Supreme Court for the Federal Government's ability to conduct foreign policy; the importance of the issue to the states and to a large number of taxpayers, as well as foreign governments; and in consideration of the long period that this issue has been pending, this Court should grant the petitioner's petition for writ of certiorari.

ARGUMENT

THIS CASE PRESENTS THE APPROPRIATE VEHICLE TO DECIDE THE FOREIGN COMMERCE CLAUSE ISSUE SPECIFICALLY LEFT OPEN BY THIS COURT IN *CONTAINER*, WHICH HAS BEEN THE SUBJECT OF LITIGATION FOR THE NINE YEARS SINCE THAT DECISION AND WHICH HAS ENORMOUS IMPACT ON THE FEDERAL GOVERNMENT'S ABILITY TO FORMULATE FOREIGN TRADE POLICY.

Article I, § 8, cl. 3 of the United States Constitution reserves to Congress the power to regulate commerce with foreign nations and among the states. This Clause, "by its own force created an area of trade free from interference by the States" and "even without implementing legislation by Congress is a limitation upon the power of the States." *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 328 (1977). With regard to foreign commerce, the "constitutional prohibition against state taxation . . . is broader than the protection afforded to interstate commerce . . . because matters of concern to the entire Nation are implicated." *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, —— U.S. ——, 112 S. Ct. 2365, ——, 60 U.S.L.W. 4582, 4584 (1992). Thus, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court stated that "[f]oreign commerce is preeminently a matter of national concern," 441 U.S. at 448, and held that a state tax violates the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential." 441 U.S. at 448.

In *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court elaborated on the "one voice" requirement of *Japan Line*, stating that where foreign affairs are implicated, the "one voice" standard is violated if the state tax "*either* implicates foreign policy issues which must be left to the Federal Government *or*

violates a clear federal directive." 463 U.S. at 194 (emphasis in original). This Court went on to state that "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.*

In *Container*, this Court felt that it could not determine when a foreign nation might be offended by a state tax policy. *Id.* However, one no longer has to speculate about whether foreign trading partners are so offended by worldwide combined reporting that retaliatory actions might be taken. In 1985, the United Kingdom enacted retaliatory legislation that would deny certain tax credits provided by the United States/United Kingdom Income Tax Treaty to United States corporations doing business in a state imposing worldwide combined reporting.[2] Finance Act of 1985, section 54, recodified as Section 812 of the Income and Corporation Taxes Act of 1988. Although the United Kingdom has not yet triggered this provision, as this Court recognized in *Japan Line*, "[t]he risk of retaliation . . . under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 450.[3] The risk is all the

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[2] Under the United States/United Kingdom Income Tax Treaty, a United States corporation receives a refund of certain amounts of taxes withheld by a United Kingdom payor on dividends paid by that payor. United States corporations are entitled to this refund for taxes paid on dividends received from U.K. subsidiaries or investments of at least 10% in unrelated U.K. corporations.

[3] The impact of the United Kingdom's retaliatory statute is not limited to California based corporations. The statute denies the refund otherwise due a United States corporation under treaty if the U.S. corporation or one of its affiliates has a "qualifying presence" in California. Income and Corporations Taxes Act of 1988 ("1988 Act") section 812(1). The United Kingdom may, at its discretion, consider a company to have a qualifying presence within California simply if it is subject to tax by the State, 1988 Act, section 812(7), or if the corporation has relatively small property, payroll or sales in California. 1988 Act, section 812(3). There-

more acute in the face of the decision of the California Supreme Court upholding the constitutionality of worldwide combined reporting as imposed upon a unitary group whose parent is a United Kingdom corporation.[4] As this Court stated in *Japan Line*, "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453. The Foreign Commerce Clause issue presented in this case is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that it must not be left unanswered any longer. *See, Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 485-486 (1975).

Taxpayers have challenged worldwide combination on Foreign Commerce Clause grounds since the State of California began enforcing this form of taxation. *Container* involved tax years 1964 through 1966 and although the State's tax assessments were issued in 1969, the final determination in that case was not rendered until this Court's decision in 1983. The dispute in *Barclays*, which involves the 1977 tax year, was pending during the *Container* litigation and nine years later, fifteen years after the tax year at issue, the Court finally has an opportunity to end this unduly drawn-out process for the taxpayer and to answer the question it left open in *Container*. As the Franchise Tax Board pointed out in both

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fore, a corporation doing business in every state except California and which receives dividends from investments in U.K. corporations, may face a greatly increased U.K. tax burden if it is affiliated with a corporation with minimal contacts with California.

[4] In *Unitary Tax: Review of Progress Towards Resolving the Problems*, a Joint Report by Inland Revenue and the U.S. Treasury, issued in December, 1991, the United Kingdom reviewers concluded that, pending settlement of the issue of the constitutionality of worldwide combined reporting through litigation, the United Kingdom "should maintain its retaliatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it." ¶ 7.2.a.

its Petition for Review and Brief on the Merits in the California Supreme Court, *Barclays* is the "test case" with regard to foreign parent unitary groups. Petition at 2, n.1, Brief at 5, n.6. This case affects not only Barclays, but also the large number of other taxpayers waiting for a final determination of the issue of whether worldwide combined reporting as imposed on foreign parent unitary groups violates the Foreign Commerce Clause. It is time that these taxpayers, who have held their cases in abeyance pending the *Barclays* test case, receive an answer.[5]

The decision of the Califorina Supreme Court, if left unreviewed, also creates a dangerous precedent through its misapplication of *Wardair Canada v. Florida Department of Revenue*, 477 U.S. 1 (1986). According to the decision of the California Court, Congressional ratification of worldwide combined reporting is evidenced by the fact that Congress has not, either in a committee or in the full House or Senate, voted on legislation preventing such a state tax on foreign commerce.[6] However, this

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[5] The number of affected taxpayers is so large that the Franchise Tax Board was compelled to issue FTB Notice No. 89-714, on November 17, 1989, outlining the procedure to be used by taxpayers to defer cases pending a decision of the Foreign Commerce Clause issue in *Barclays*. Pet. App. G.

[6] The California Supreme Court did rely heavily on the Senate's actions in ultimately ratifying the United States-United Kingdom income tax convention without a prohibition of states' use of worldwide combined reporting. However, this was not an action that was taken by the entire Congress. Only the Senate gives its consent to foreign treaties. U.S. Constitution. Art. II, § 2. This action cannot be imputed to the House or used as evidence of *Congressional* approval of California's use of worldwide combined reporting. There is no authority to support the California Supreme Court's use of the failure of two-thirds of the Senate to ratify a treaty containing a specific provision, pursuant to its powers under Article II of the Constitution, as evidence of the intent of the majority of the Congress to approve, pursuant to Article I of the Constitution, a state tax affecting foreign commerce.

Court's decision in *Wardair* did not hold that governmental silence could foreclose a dormant Foreign Commerce Clause analysis. Rather, the Court stated that it is just such governmental silence that triggers that analysis, but that such analysis was not applicable in *Wardair* because the federal government had affirmatively acted by entering into international agreements explicitly limiting certain local tax powers. *Wardair*, *supra* at 9-10. The California Supreme Court's misreading and misapplication of *Wardair* could be used to justify any state action affecting foreign commerce where Congress has not acted, effectively destroying the protections to foreign trade provided by the dormant Commerce Clause. This broader issue, as well as the specific issue with regard to worldwide combined reporting, requires review and clarification by this Court.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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Dated: August 31, 1992

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OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of the State of California

BRIEF FOR NESTLÉ HOLDING, INC. AND GENSTAR COMPANY AS AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTEREST OF AMICI CURIAE

The amici curiae are corporations incorporated, commercially domiciled and doing business in the United States. Each is owned entirely by a corporation incorporated in a foreign country. Each is presently engaged in a franchise tax controversy with the California Franchise Tax Board regarding, *inter alia*, the ability of the Franchise Tax Board to include the United States operations of the amici curiae and their United States subsidiaries in a single unitary business with their foreign parent corporations and the other foreign affiliates of those foreign parent corporations. The foreign opera-

tions that are the subject of these controversies are entirely conducted by corporations incorporated, commercially domiciled and doing business in foreign countries. The amici therefore have a strong interest in the constitutional principles governing methods of state taxation that adversely affect governmental relations between the United States federal government and foreign governments. The California Supreme Court's decision would substantially alter those principles by treating congressional silence as consent to the Franchise Tax Board's worldwide unitary method of taxation. Such an alteration would significantly affect both the tax liabilities of the amici and the environment in which they conduct their business. Specifically, allowing the California Supreme Court's decision to stand would affect the relationship between the government of the United States and the governments of the countries (Switzerland and Canada) in which the parent corporations of the amici are based.

Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

SUMMARY OF THE ARGUMENT

I. When Congress exercises its power under the Commerce Clause to consent to a state law, any question of the validity of that state law under the dormant Commerce Clause disappears, even though that state law might otherwise burden interstate or foreign commerce. Recognizing the considerable consequences that emanate from a finding of congressional consent, this Court has consistently required that Congress manifest its consent to state law through clear unambiguous affirmative action. *See, e.g., Wyoming v. Oklahoma,* 112 S. Ct. 789, 802 (1992); *Maine v. Taylor,* 477 U.S. 131, 138-9 (1986); *South-Central Timber Development, Inc. v. Wunnicke,* 467 U.S. 82, 91-92 (1984); *Sporhase v. Nebraska ex rel. Douglas,* 458 U.S. 941, 960 (1982); *New England Power Co. v. New Hampshire,* 455 U.S. 331, 343 (1982).

Despite this well-established body of case law, the California Supreme Court found congressional consent to California's use of the worldwide combined reporting method

of taxation not in unambiguous affirmative action, but rather in "the din of a 'governmental silence'." Pet. App. A-26. The California Supreme Court justified its novel approach by relying almost exclusively on this Court's decision in *Wardair Canada Inc. v. Department of Revenue*, 477 U.S. 1 (1986), finding that case to represent "if not a change of course in the high court's dormant commerce clause jurisprudence, at least a retrenchment in its scope." Pet. App. A-24. However, the California Supreme Court's conclusion that congressional silence and inaction can form the basis of congressional consent cannot be reconciled with *Wardair* or decisions of this Court prior to and following *Wardair*. Indeed, *Wardair* itself found consent on the basis that "the Federal Government has not remained silent" but rather "has affirmatively decided to permit" the state taxation at issue. *Wardair*, 477 U.S. at 12.

The California court's attack on this Court's criteria for determining congressional consent warrants review. First, important policies of free trade protection surround this Court's insistence on clear expressions of congressional consent, and these policies will be jeopardized if review is not granted. Moreover, if the standard for determining congressional consent is to be so dramatically curtailed, it is the prerogative of this Court, not the California Supreme Court, to so rule. Second, the California Supreme Court's misreading of *Wardair* demands correction. *Wardair* does not represent a retrenchment in the scope of this Court's dormant Commerce Clause jurisprudence, but rather is fully consistent with this Court's earlier, as well as later, decisions. It is incumbent upon this Court to clarify any confusion surrounding the standards for congressional consent in order to prevent further misreading by other courts. Finally, and perhaps most importantly, if congressional silence alone can justify congressional consent, the scope of protection from burdensome state laws offered by the dormant Commerce Clause will be severely restricted, perhaps to the extent that such protection will become nonexistent. The implications of the decision below are therefore destructive of the free trade purpose underlying the Commerce Clause and must not be left undisturbed by this Court.

II. The inaction of Congress in this case is inconsistent with any plausible view of consent and certainly does not establish the factual basis for consent found in *Wardair*. Whereas the Court in *Wardair* found consent in a series of international agreements that specifically considered the state taxation at issue, the California Supreme Court found consent by implication in a series of congressional inactions and failures to act. Four of the five items of inaction relied on by the California Supreme Court to find congressional consent do not even mention the question of states' use of worldwide combined reporting, expressing no more than a preference for separate accounting at the federal level. The single item relied on by the California Supreme Court which addresses the taxing method at issue is the failure to obtain the necessary two-thirds votes to ratify a treaty containing a provision prohibiting states' use of worldwide combined reporting. However, a majority of senators voted to support the provision, negating any possible inference of consent from the failure to act.

Finally, the five factors found by the California Supreme Court to constitute congressional consent all existed prior to this Court's decision in *Container Corporation of America v. Franchise Tax Board*, 458 U.S. 159 (1983). Nevertheless, despite the presence of these factors at that time, this Court engaged in dormant Commerce Clause analysis and therefore did not find that Congress had consented to worldwide combined reporting.

REASONS FOR GRANTING THE PETITION

This case presents issues of considerable importance to the foreign relations of the United States and to the Court's Foreign Commerce Clause jurisprudence. As detailed in Barclays' petition, and in the supporting briefs filed by other amici, California's worldwide combined reporting requirements, particularly as applied to multinational corporate affiliates with foreign parents, have been the focus of enormous international controversy. Moreover, the decision below sustaining California's taxing scheme disregards "sensitive matters of foreign relations and national sovereignty" recognized by the Court in *Japan Line, Ltd. v. County of Los Angeles*, 441

U.S. 434, 456 (1979). These considerations alone justify the grant of Barclays' petition.

There is, however, another compelling reason for reviewing the decision below: The California Supreme Court invented an unwarranted approach to ascertaining whether Congress has consented to state law under the Commerce Clause, and thereby precluded an inquiry into the validity of the law under the dormant Commerce Clause. By discovering congressional consent in the "din of a 'governmental silence'" (Pet. App. A-26), the court below has made a mockery of the very concept of consent. Moreover, the court's analysis cannot be reconciled with this Court's precedents that consistently refuse to infer congressional approval of state action from congressional inaction. In urging the Court to grant Barclays' petition, amici Nestlé Holdings, Inc., et al. focus their attention on the critical question of Commerce Clause jurisprudence raised by the California Supreme Court's disposition of the congressional consent issue.

I. THE CALIFORNIA SUPREME COURT'S VIEW THAT CONGRESS' SILENCE CONSTITUTES CONSENT UNDER THE COMMERCE CLAUSE IS INCOMPATIBLE WITH THIS COURT'S PRECEDENTS AND THE FREE TRADE PURPOSES UNDERLYING THE COMMERCE CLAUSE

A. In Recognizing Congress' Power to Consent to State Laws That Would Otherwise Be Unconstitutional Under the Dormant Commerce Clause, This Court Has Equated Consent With Affirmative Congressional Action

The appropriate standard for determining when Congress has consented to state law under the Commerce Clause is rooted in the underlying principle that accords congressional consent its crucial constitutional function in this domain. The principle was first articulated a century ago in *In re Rahrer*, 140 U.S. 545 (1891), and given its definitive modern exposition in *Prudential Ins. Co. v. Benjamin*, 328 U.S. 408 (1946).

In *Prudential*, the Court considered a challenge under the negative implications of the Commerce Clause to a South Carolina tax on insurance companies that allegedly discriminated against interstate commerce. Congress had provided in the McCarran Act, however, that "taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the... taxation of such business...." 15 U.S.C. § 1011. In addressing the question whether its dormant Commerce Clause cases had any bearing on the taxpayer's claim, the Court first observed that "[t]hose cases... presented no question of the validity of such a tax where Congress had taken *affirmative action* consenting to it...." 328 U.S. at 421 (emphasis supplied).

Because the taxpayer argued that the Commerce Clause, by its own force, nevertheless limited "Congress' permissible *action* in this respect" (*id.* at 422 (emphasis supplied)), the Court proceeded to address the merits of the question. The Court put the question this way: "[I]f the commerce clause, 'by its own force' forbids discriminatory state taxation, or other measures, how is it that Congress *by expressly consenting* can give that action validity?" *Id.* at 426 (emphasis supplied). The answer was easy. When Congress has *acted* under its commerce power, whether to preempt or consent to state laws, any question of the validity of the state law under the dormant Commerce Clause simply disappears. Indeed, "whenever Congress' judgment has been *uttered affirmatively* to contradict the Court's previously expressed view that specific action taken by the states in Congress' silence was forbidden by the commerce clause, this body has accommodated its previous judgment to Congress' *expressed approval*." *Id.* at 425 (emphasis supplied). Since Congress had *"expressly stated* its intent and policy" (*id.* at 427 (emphasis supplied)) regarding the states' freedom to tax the insurance industry in the McCarran Act, the Court was "not required to determine whether South Carolina's tax would be valid in the dormancy of Congress' power." *Id.*

The requirement that Congress' consent to state laws under the Commerce Clause be reflected in Congress' affirmative action is necessitated by the profound consequences of finding such consent. As the Court noted in *Prudential*, because Congress has plenary power over the channels of interstate commerce, "Congress may keep the way open, confine it broadly or closely, or close it entirely" (*id.* at 434), subject only to the limitations that the Constitution imposes on Congress' own power. This includes, of course, the power to authorize state laws that discriminate against or otherwise burden interstate commerce, laws that would be struck down in the absence of congressional action consenting to them. *Id.* By clearly indicating that congressional consent was a function of affirmative action by Congress, the Court in *Prudential* protected the values underlying the dormant Commerce Clause from erosion through findings of implied congressional consent while recognizing Congress' plenary power to expand or contract state tax power without regard to the restraints imposed by the dormant Commerce Clause.

B. This Court's Precedents Uniformly Require That Congress Manifest Its Consent to State Laws Under the Commerce Clause by Unambiguous Affirmative Action

Because Congress' consent to state laws under the Commerce Clause completely removes them from judicial scrutiny under the negative Commerce Clause, the Court, faithful to the teachings of *Prudential*, has properly insisted that Congress manifest its consent to state law through unambiguous affirmative action. Thus the Court has repeatedly stressed that "an unambiguous indication of congressional intent is required before a federal statute will be read to authorize otherwise invalid state legislation" and provide an "exemption from Commerce Clause scrutiny." *Maine v. Taylor*, 477 U.S. 131, 138-39 (1986); *see also Wyoming v. Oklahoma*, 112 S. Ct. 789, 802 (1992) ("Congress must manifest its unambiguous intent before a federal statute will be read to permit or approve... a violation of the Commerce Clause"); *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82,

91-92 (1984) (rejecting "'implicit approval' theory" of congressional consent and reaffirming "a rule requiring a clear expression of approval by Congress"); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982) ("[i]n the instances in which we have found such [congressional] consent, Congress' '"intent and policy" to sustain state legislation from attack under the Commerce Clause' was '"expressly stated"'"); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 343 (1982) ("when Congress has not 'expressly stated its intent and policy' to sustain state legislation from attack under the Commerce Clause,... we have no authority to rewrite its legislation based on mere speculation as to what Congress 'probably had in mind'").

Without such a rule of unambiguous congressional action as a predicate to finding that Congress has consented to state law under the Commerce Clause, the fundamental values that the Commerce Clause was designed to protect would be jeopardized. The Court has recognized that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944). The Court has protected the core value of free trade within a national market in its numerous decisions under the dormant Commerce Clause striking down state laws that burden interstate commerce. To be sure, Congress is free to remove the protective shield of these decisions when it sees fit to do so. But to expose interstate or foreign commerce to burdensome state legislation without the clearest signal from Congress of its intent to strip such commerce of the protections it ordinarily enjoys would undermine our constitutional scheme. "Absent a 'clear expression of approval by Congress,' any relaxation in the restrictions on state power otherwise imposed by the Commerce Clause unacceptably increases 'the risk that unrepresented interests will be adversely affected by restraints on commerce.'" *Maine v. Taylor*, 477 U.S. at 139.

C. The California Supreme Court's Novel Approach to Ascertaining Congressional Consent to State Laws Under the Commerce Clause Cannot Be Reconciled With This Court's Decisions and Raises an Issue of Broad National Significance Warranting Review by This Court

Despite the large and settled body of case law bearing on congressional consent to state law under the Commerce Clause, the decision below virtually ignored it in holding that congressional consent could be found in "a species of governmental *silence* that forecloses resort to a dormant foreign commerce clause analysis." Pet. App. A-21 (emphasis in original). As a result, the court relied on a series of congressional inactions in finding that Congress had consented to California's requirement of worldwide combined reporting. *See* pp. 14–15, *infra*. Even if these congressional inactions were relevant to the question of consent under the Commerce Clause, we demonstrate below that they could not conceivably support the inference that Congress has, in fact, consented to California's taxing scheme. *See* pp. 15–20, *infra*. First, however, we consider the more fundamental error of the opinion below, namely, that congressional silence can lay the foundation for a finding of Congress' consent to state law under the Commerce Clause.

The California court's view that "the din of a 'governmental silence'" (Pet. App. A-26) provides a legitimate basis for discerning congressional consent to state law, thereby obviating an inquiry into the law's validity under the dormant Commerce Clause, rests entirely on its reading of *Wardair Canada Inc. v. Department of Revenue*, 477 U.S. 1 (1986). *Wardair* involved the imposition of a Florida sales tax on aviation fuel purchased in Florida by a foreign air carrier for use in international flights. The carrier challenged the tax on two theories: first, it was preempted by federal legislation; second, it was barred by the dormant Commerce Clause.

The Court rejected the preemption argument on the ground that Congress had expressly permitted the states to impose "sales or use taxes on the sale of goods or services"

(Federal Aviation Act of 1958, § 1113(b), 15 U.S.C. § 1513), which included airline fuel. 477 U.S. at 6-7. Such an affirmative statement by Congress might itself have been deemed sufficient to constitute consent to the state law, thereby precluding any further inquiry into the matter under the negative implications of the Commerce Clause. The Court nevertheless felt compelled to go further in responding to the taxpayer's dormant Commerce Clause argument because it felt Congress may not have expressly considered the imposition of such taxes on *foreign* air carriers in enacting section 1113 of the Federal Aviation Act, even though that section did not by its terms distinguish between foreign and domestic carriers. 477 U.S. at 7. Thus, consistent with its precedents addressing congressional consent to state law (*see* pp. 7–8, *supra*), the Court adopted an extremely high standard for finding express approval of a state tax, requiring a clear indication that Congress had intentionally taken legislative action manifesting consent to the tax.

The Court did not need to look far beyond the Federal Aviation Act, however, in order to find that Congress through unambiguous affirmative action had given its approval to the state tax in question. Thus the Court relied on a series of international agreements which "demonstrate that the Federal Government has *affirmatively acted*, rather than remained silent, with respect to the power of the States to tax aviation fuel." *Id.* at 9 (emphasis supplied). The "*actions* taken by the Federal Government [which] accept the authority of the States to tax as Florida has here" (*id.*) (emphasis supplied) included the Chicago Convention on International Aviation, which specifically addressed the question of state and local taxation of aviation fuel, and more than 70 bilateral agreements that "acquiesced in state taxation of fuel used by foreign carriers in international travel." *Id.* at 12.

What all this made "abundantly clear" (*id.*) to the Court was that "the Federal government *has not remained silent* with regard to the question whether the States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel." *Id.* (emphasis supplied). Because the

"Federal Government *has affirmatively decided* to permit the States to impose these sales taxes on aviation fuel" (*id.*) (emphasis supplied), and because "it would turn dormant Commerce Clause analysis upside down to apply it where the *Federal Government has acted*" (*id.*) (emphasis supplied), the Court concluded that Congress had consented to the Florida tax and there was no need to consider its validity under the dormant Commerce Clause.

Despite the Court's unequivocal holding in *Wardair*, which reflects the lessons of its earlier decisions, that affirmative congressional action is the touchstone of congressional consent to state law under the Commerce Clause, the court below nevertheless found that Congress had consented to California's worldwide combined reporting scheme on the basis of congressional silence and inaction. *See* pp. 14–20, *infra*. The court justified its departure from this Court's precedents on the ground that *Wardair* itself "represents, if not a change of course in the high court's dormant commerce clause jurisprudence, at least a retrenchment in its scope." Pet. App. A-24. According to the court below, *Wardair* "can be abstracted into a kind of protocol for identifying those kinds of governmental silences that give rise to 'negative implications' supporting an inference of federal acquiescence in the state tax under challenge." Pet. App. A-23. And it read *Wardair* as "establish[ing] an interpretive framework for educing from a compilation of legislative materials a species of governmental *silence* that forecloses resort to dormant commerce clause analysis." Pet. App. A-21 (emphasis in original).

The California Supreme Court's frontal assault on this Court's criteria for determining when Congress has consented to state law under the Commerce Clause plainly warrants the Court's plenary review. In the first place, there is no justification either in constitutional policy or in this Court's precedents for the extraordinary suggestion of the court below that Congress' silence constitutes consent under the Commerce Clause. As we have explained above, both the policy and law are to the contrary, and the California court has advanced no sound reason for abandoning it. In any event, it is clearly the

prerogative of this Court — not a state court — to determine whether its decisions should be overturned. *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

Second, even if there are some suggestions in *Wardair* that the "negative implications" (477 U.S. at 10, 12) of affirmative congressional action can lay the evidentiary predicate for a finding of congressional consent to state law, these suggestions do not license a state court to base a finding of consent on the negative implications of congressional *inaction*, which is what the California court did here. *See* pp. 13–20, *infra*. The Court in *Wardair* explicitly declared that it was drawing negative inferences from governmental action — not governmental omission — in finding that Congress had affirmatively consented to the tax at issue.

Third, the suggestion that *Wardair* "represents, if not a change of course in the high court's dormant commerce clause jurisprudence, at least a retrenchment in its scope" (Pet. App. A-24) is unfounded. *Wardair* is woven from the same cloth as the Court's earlier decisions involving congressional consent (*see* pp. 7–8, *supra*), as well as from its later decisions. *Id.* Indeed, the claim that there has been a "retrenchment" in the Court's foreign Commerce Clause jurisprudence is belied by the Court's most recent decision in this domain. *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*, 112 S. Ct. 2365 (1992). In any event, insofar as one might read *Wardair* as relaxing the standards for finding congressional consent to state law, *Wardair*, 477 U.S. at 18-20 (Blackmun, J., dissenting), it is incumbent upon this Court to clarify those standards so they will not be subject to the misreading that they received below.

Finally, the implications of the decision below are so destructive of the free trade purposes underlying the Commerce Clause, which provides the basis for this Court's dormant Commerce Clause jurisprudence, that it should not be left undisturbed. Under the California court's analysis, "silence" becomes a basis for inferring consent to state law under the Commerce Clause. Yet it is this very "silence" that

has for two centuries been the basis for the Court's dormant Commerce Clause jurisprudence. If congressional silence can justify a finding of congressional consent to state laws, then there may well be no room for the dormant Commerce Clause to operate at all. At a minimum, its scope may be substantially narrowed, and courts will have to distinguish between the kinds of "silence" that warrant a dormant Commerce Clause inquiry and those that preclude judicial scrutiny of the state law altogether. These questions are indisputably worthy of this Court's attention.

II. THE DECISION BELOW CANNOT BE RECONCILED WITH *WARDAIR* AND RENDERS THE CONCEPT OF CONGRESSIONAL CONSENT MEANINGLESS

The inaction of Congress in this case is inconsistent with any plausible view of consent and certainly does not establish the factual basis for consent found in *Wardair*. If left undisturbed, the California's court's opinion would leave the law in this area in shambles.

As noted above, in *Wardair*, this Court found it unnecessary to engage in dormant Commerce Clause analysis because it was "abundantly clear" that the federal government had *acted* rather than remained silent. *Wardair*, 477 U.S. at 12. The Court found this affirmative action in three documents: (1) the Chicago Convention on International Civil Aviation entered into by the United States on December 7, 1944; (2) a Resolution adopted November 14, 1966, by the International Civil Aviation Organization, of which the United States is a member; and (3) bilateral agreements into which the United States had entered with various foreign countries.

The Chicago Convention specifically considered subnational taxation of aviation fuels and prohibited local taxes on fuel only when the fuel was "on board an aircraft... on arrival... and retained on board on leaving." Consistent with well-settled principles of statutory construction, *see Sutherland Stat. Const.* § 47.23 (5th ed.), this Court found that, by directly addressing the question of state taxation of aviation fuel and specifying which taxes could not be imposed, the federal gov-

ernment was thereby consenting to the imposition of other state taxes, including the state tax at issue in that case. *Id.* at 10.

With respect to the 1966 Resolution, on the other hand, even though it endorsed an international scheme to exempt fuel "from all customs and other duties," the Court found that this did not negate the congressional policy reflected in the 1944 Chicago Convention. The Resolution was found not to be action by the government of the United States but merely the work product of an organization to which the United States belonged.

The Convention established the context within which the Court considered the subsequent bilateral aviation agreements with foreign countries. In light of the Convention and the Resolution, both of which specifically addressed the concern of subnational taxation, the Court found that the express language of the agreements precluding only national taxes on aviation fuel reflected a conscious decision by the federal government to allow the state taxes at issue in the case. The Court therefore concluded that "the Federal Government has affirmatively decided to permit the states to impose these taxes on aviation fuel" (477 U.S. at 12) and dormant Commerce Clause analysis was inappropriate.

The affirmative action found to establish consent in *Wardair* stands in stark contrast to the five items of inaction relied on by the California Supreme Court to support the proposition that Congress has consented to states' use of worldwide combined reporting. These five items of inaction include the following:

1. Failure to consider state taxes in any income tax treaties with foreign nations, except in nondiscrimination clauses;

2. The absence of any provision restricting state taxes of any sort in various model income tax treaties;

3. The absence of restrictions on state taxation in Friendship, Commerce & Navigation ("FCN") treaties to which the United States is a party;

4. The absence of enacted congressional legislation prohibiting or restricting the worldwide unitary method; and

5. Failure to obtain the necessary two-thirds vote to ratify a treaty containing a provision prohibiting use of the worldwide unitary method by the states.

The first three factors relied on by the California Supreme Court neither directly address nor, indeed, even consider the question of worldwide combined reporting at the subnational level. The treaties, while requiring use of separate accounting at the national level, are *silent* on the issue of separate accounting at the state level. Yet the California Supreme Court found that "an extensive pattern of executive branch-negotiated diplomatic texts parallels, in our view, Congress' own unwillingness to disallow legislatively the states' application of formula apportionment methods to foreign controlled multinational taxpayers, and bespeaks a coordinate 'acquiescence.'" (Pet. App. A-34.)

Such a suggestion is absurd. If congressional consent is to retain any meaning, it cannot be held that an expression of a federal preference for separate accounting stands for the proposition that Congress thereby consents to states' use of worldwide combined reporting. Indeed, if such an analysis is allowed to stand unchallenged, any treaty that regulated federal taxation at the national level, or failed to consider a particular state taxation method, would reflect a conscious congressional decision to allow states to tax in any manner they please. Such a result would render dormant Commerce Clause analysis obsolete. If the Senate ratified a treaty which included a provision specifically prohibiting or permitting a state taxation method, clearly dormant Commerce Clause analysis would be irrelevant; similarly, however, under the California Supreme Court's approach, if that same treaty were silent on the issue of state taxation, that silence would reflect affirmative approval of and consent to any particular taxing method used by the states, thereby also rendering dormant Commerce Clause analysis irrelevant.

The California Supreme Court's finding that these treaties "parallel the *Wardair* paradigm" (Pet. App. A-34) is also inapt. The treaties at issue in this case are vastly different from the bilateral agreements at issue in *Wardair*. In *Wardair*, the specific subject matter encompassing the tax at issue had been addressed in both the Chicago Convention and the Resolution. The subsequent bilateral agreements were therefore entered into in the context of these foundational documents and the absence of reference to state taxation reflected a congressional policy to leave unchanged the state tax boundaries established by those earlier documents. In contrast, the treaties and other bilateral agreements at issue in this case did not emanate from any congressional understanding or accord on the subject of state taxation of the income of multinational corporations. Rather these treaties were negotiated and entered into in the context of congressional silence on the subject of state taxation of multinationals and therefore no congressional intent can be attributed to the absence of state taxation regulation.

The California Supreme Court asserted that the fact that the tax treaties contained nondiscrimination clauses applicable to the states demonstrates that state taxation was in fact at issue in these treaties. Again, however, it is hard to see how a general provision precluding states from taxing foreign corporations at a higher rate than domestic corporations implicates the question of states' use of worldwide combined reporting in such a way that an absence of consideration of that issue in these treaties can in fact be seen to be significant and reflective of congressional policy. Moreover, this general reference to state taxation stands in stark contrast to the specific congressional consideration of the particular subnational tax at issue in the Chicago Convention. Surely, if congressional consent is to have any substantive meaning, then a general nondiscrimination provision cannot give rise to a *Wardair* "negative implication."

The negative implications of these treaties are, therefore, quite different from the negative implications of the bilateral agreements in *Wardair*. Indeed, what this Court found in *Wardair* was that there "was not the federal governmental si-

lence of the sort that triggers dormant Commerce Clause analysis" because "the Federal Government *has affirmatively acted, rather than remained silent.*" 477 U.S. at 9 (emphasis supplied).

This distinction is significant when considering the fourth factor found to be significant by the California Supreme Court — the absence of enacted congressional legislation prohibiting or restricting the use of worldwide combined reporting to foreign-based multinationals. Failure to enact legislation is clearly not "affirmative action" of the type that can be considered in any *Wardair*-type analysis.

The only factor that specifically addresses the application of worldwide combined reporting to foreign-based enterprises is the last. However, this factor provides no more insight into congressional policy than the prior four. In 1975, the Executive Branch negotiated an income tax treaty[1] with the United Kingdom that contained a provision, article 9(4), that would have prohibited the states' application of worldwide combined reporting to U.K.-based groups. Senator Frank Church introduced a "reservation" to 9(4) in the Senate Foreign Relations Committee which would have effectively removed 9(4) from the treaty. This Church reservation was *defeated* 10 to 5 in the Senate Foreign Relations Committee. The reservation was then voted upon on the Senate floor, and, again, *defeated* 44 to 34. The treaty with article 9(4) included received a favorable vote of 49 to 32, falling only 5 votes short of

---

[1] Convention for the Avoidance of Double Taxation, Dec. 31, 1975, U.S.-U.K., 31 U.S.T. 5668, TIAS 9682 (entered into force Apr. 25, 1980).

the required two-thirds vote necessary for the ratification of a treaty. Finally, 9(4) was reserved without a vote and the treaty was ratified with the reservation.[2]

It is from these three majority votes in favor of *prohibiting* states' use of worldwide combined reporting that the California Supreme Court found a congressional policy *permitting* states' use of worldwide combined reporting. Ignoring the majority votes in favor of 9(4), the California Supreme Court focused its attention on the failure to achieve the two-thirds majority necessary to ratify the treaty with article 9(4) included. As always it is dangerous to speculate on the meaning of congressional inaction, but it appears from the congressional record that the merits of worldwide combined reporting were not the primary focus of the debate surrounding article 9(4). Rather the failure to ratify the treaty with article 9(4) included seems to reflect more the concern of the Senate that the treaty ratification process was not the appropriate forum to consider such a curb on states' powers. The more appropriate forum was Congress. One senator expressed it as follows:

> Now that the State authority has been confirmed by judicial opinion, this treaty seeks to curb that power by treaty negotiation — not by constitutional amendment and not by act of Congress.
>
> I cannot support such unwarranted extension of the Executive's power, and must vote for the Church reservation on article 9(4).

---

[2] One Senator suggests that it was a mere quirk of congressional procedure that article 9(4) was not included in the treaty: "Last Friday, we rejected the Church reservation by a comfortable majority, only to find it reappear in today's version of the vote. Thus we combined two issues, one which requires only a majority vote, namely the Church reservation, and ratification of the treaty and its protocols which require a two-thirds vote. I would have very much preferred to follow the original suggestion of the Senator from West Virginia, made last Friday, to have two votes back to back, thereby keeping votes and issues apart. I am convinced that in this case we would have had a treaty today including article 9(4)." Remarks of Senator Morgan, 124 Cong. Rec. 19,078 (1978).

Remarks of Senator Matsunaga, 124 Cong. Rec. 18,669 (1978). Similarly, Senator Church, who introduced the reservation, expressed his concern thus:

> There are two important principles at stake in this treaty. The first concerns the role of tax treaties in our constitutional system. Whatever tax treaties are good for, they should not be used to usurp for the executive branch of Government the power to impose major changes in internal tax policy. Yet the United Kingdom Treaty does precisely this.
>
> . . .
>
> The second important principle concerns the proper way for resolving disputes within our federal system....
>
> Mr. President, Congress is the forum in which disputes within the federal system are meant to be resolved.

Remarks of Senator Church, 124 Cong. Rec. 18,416-17 (1978). Ironically, the senatorial failure to ratify the treaty is the "action" that California Supreme Court points to as most clearly showing *congressional* consent for states' use of world-wide combined reporting. Yet in the view of the senators at least, if not the California Supreme Court, *Congress* had not even considered, let alone approved of, worldwide combined reporting.

It is not surprising, therefore, that the California Supreme Court, when reviewing the five factors considered above, heard "the din of a 'governmental silence'." (Pet. App. A-26).[3] What is surprising is that the lower court found that it was a din "that cannot be ignored" (Pet. App. A-26). Certainly, this Court has found that the five "inactions" could, and should, be ignored. Each of the five items alleged here as indications of congressional consent to use of the worldwide unitary method of taxation existed prior to the United States Supreme Court's decision in *Container Corporation of America v. Franchise Tax*

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[3] "Din" is defined in *Webster's Third New International Dictionary* (1976) as "a loud noise; *esp.* a welter of confused or discordant sounds." *Id.* at 635.

Board, 463 U.S. 159 (1983). The *Container* decision refers to the income tax treaties in general, the model treaties, the failure of Congress to take action and the reservation with respect to the U.K. treaty. The FCN treaties were discussed in the Franchise Tax Board's brief in *Container*, but were not mentioned in the *Container* opinion. (*Container Corporation of America v. Franchise Tax Board, supra*, Appellee's brief at 126-29.) Yet this Court did not find that Congress had consented to the worldwide unitary method of taxation but rather that dormant Commerce Clause analysis was appropriate. Nothing has changed.

CONCLUSION

The instances of congressional inaction at issue in this case, whether taken collectively or individually, are inconsistent with any plausible view of consent. If the California Supreme Court's decision is allowed to stand the concept of congressional consent will become meaningless and the scope of the dormant Commerce Clause severely restricted. We therefore urge this Court to grant the Petition for Writ of Certiorari in this case and to give plenary consideration to this matter.

Dated: August 28, 1992.

Respectfully submitted,

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OF THE

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BARCLAYS BANK PLC,
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VS.

FRANCHISE TAX BOARD,
An Agency of the State of California,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF FOR THE INSTITUTE OF INTERNATIONAL BANKERS AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR CERTIORARI

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Pursuant to Rule 37 of the Rules of this Court, this brief is respectfully submitted in support of the Petition for Writ of Certiorari by amicus curiae the Institute of International Bankers. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of this Court.

INTEREST OF THE AMICUS CURIAE

This case involves the application by the State of California of worldwide combined reporting to a U.S. subsidiary of a foreign bank and a U.S. branch of a foreign bank. The decision below

holds that such application does not violate the Foreign Commerce Clause of the United States Constitution.

The Institute of International Bankers is comprised of bankers representing more than 200 banking organizations from over 50 countries. The Institute's members do business in the United States both directly and through subsidiaries, and many do business in California. The Institute is recognized by governmental bodies and industry groups throughout the United States as an important spokesman for international banks. The Institute's purpose is, among other things, to promote a free global financial marketplace. Worldwide combined reporting, because it is inconsistent with the taxing systems used by every nation of the world, creates a barrier to free trade and interferes with the free international flow of goods, technology and capital. Further, worldwide combined reporting, by creating uncertainty and unpredictability, acts as a barrier to the free flow of international financial services.

Accordingly, because worldwide combined reporting interferes with a free global economy, and affects both the members of the Institute and their customers, the Institute has a significant interest in the resolution of the issues in this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

A longstanding policy of the United States is to foster and encourage the free flow of goods, technology and capital. A primary object of this policy is the elimination of barriers to free trade among nations.

A free global economy is universally beneficial. It increases aggregate worldwide wealth. The converse is also true. Barriers to trade harm the global economy and cause everyone to suffer. The need for eliminating trade barriers, always important, takes on added urgency at a time, as now, when the United States depends on foreign trade and investment for the health and stability of its economy, and depends on ready access to international financial services to expand its international businesses.

This Court's decisions in *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979), and *Container Corp. v. Franchise*

Tax Board, 463 U.S. 159 (1983), take into account the imperatives of foreign trade and the role of the United States as one nation among nations. The decision below, however, ignores these concerns, ignores the need for uniformity and the frustration of U.S. economic policy caused by worldwide combined reporting, and even ignores the analysis set forth by this Court in those cases. This Court's failure to review that decision may be regarded as tacit approval of the California Supreme Court's perception of a lessened sensitivity in matters of foreign commerce.

ARGUMENT

The United States has for many years been a net importer of both goods and capital. With its growing trade deficit, the United States has become reliant on foreign capital to finance its high standard of living.[1] United States businesses rely on foreign markets for their goods and services, and depend on ready access to foreign financial services to support their operations overseas.[2] In short, the economy has become globalized, and it is imperative that the United States maintain the free and open international movement of goods, services and capital.

Differing tax systems, like differing regulatory systems, act as barriers to trade, in part because they can lead to uncertainty and unpredictability. To mitigate such uncertainty and unpredictability for United States business abroad as well as for foreign business in the United States, the United States has long advo-

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[1] Statement of the Securities Industry Association to the Committee on Ways and Means, U.S. House of Representatives, July 21, 1992; Statement of Fred T. Goldberg, Jr., Assistant Secretary (Tax Policy), Department of the Treasury, Before the Committee on Ways and Means, U.S. House of Representatives, July 21, 1992.

[2] International banks permit the free flow and translation of the various currencies, as well as reduce costs of international transactions by engaging in interest rate and currency swaps. With the expansion and diversification of our economy, it is important for United States business to be able to obtain readily international financial services, such as overseas drafts, letters of credit, banker's acceptances, etc.

cated the adoption of a uniform standard for the division of income of international businesses, the arm's-length method.

The arm's-length method is now the practice of nations. *Container Corporation v. Franchise Tax Board*, 463 U.S. at 184. The common standard eases tensions between nations because it provides a framework for assigning jurisdiction among nations over profits for taxation, for working out differences, and for mitigating potential double taxation among nations arising from such differences.

This Court has recognized the particular need for uniformity in foreign commerce and has been sensitive to the special concerns and imperatives of international trade and commerce. *Japan Line*, 441 U.S. 434; *Container*, 463 U.S. 159; *Kraft General Foods v. Iowa Dep't of Revenue and Fin.*, ____ U.S. ____, 112 S.Ct. 2365, 2370 (1992). The decision below, on the other hand, is particularly insensitive. The California Supreme Court dismissed as mere "aspirations" more than fifty years of United States effort in promoting the international standard in furtherance of United States foreign economic policy. The court below ignored the international tensions created by the advent of worldwide combined reporting as a method incompatible and competing with the arm's-length standard to divide international income between California, the economic size of a nation-state, and the rest of the world.

Such tensions carry the potential for harm to the nation as a whole. *Chy Lung v. Freeman*, 92 U.S. 275, 279-80 (1875); *Japan Line*, 441 U.S. at 450-51. Because of this risk, which must be weighed by the national government, not a subnational unit, this Court set out clear guidelines for determining when a state tax frustrates essential national uniformity and prevents the Nation from speaking with one voice. *Container*, 463 U.S. at 193-97; *Japan Line*, 441 U.S. at 450, 452-54. This case meets those guidelines. This Court need not speculate on foreign offense, retaliation or threat of retaliation arising from the application of worldwide combined reporting. The record in this case is clear.

The decisions of the lower California courts were consonant with the decisions of this Court in recognizing the need for

heightened scrutiny in matters of national and international concern. Those courts followed this Court's decisions in *Japan Line* and *Container*, and were cognizant of this Court's strong reaffirmations of the importance of uniformity in the international arena in *Wardair Canada v. Florida Dep't of Revenue*, 477 U.S. 1 (1986). The California Supreme Court, however, felt free to disregard dormant commerce clause analysis on the basis that the sequence of the three cases (*Japan Line, Container* and *Wardair*) reflected a lessening of this Court's concerns. The California Supreme Court then posited its own test to determine whether a state tax was removed from commerce clause scrutiny, one which draws "negative implications" from Congressional failure to forbid the tax. The California "negative implications" test thus requires Congress to rein in a state, rather than requiring explicit Congressional approval for a state to burden commerce. This new test has ramifications beyond this Court's *foreign* commerce clause decisions.

The California Supreme Court strayed from the fold and became lost. The decision of that court not only is irreconcilable with this Court's decisions in *Container* and *Japan Line*, because it ignores the dormant commerce clause analysis mandated by those cases, but also directly conflicts with this Court's standard that "Congress must manifest its unambiguous intent" to permit a State action that burdens commerce. *Wyoming v. Oklahoma*, ____ U.S. ____, 112 S.Ct. 789, 802 (1992).

It is imperative that this Court review the decision below now. Failure to do so may be taken as concurrence in the California court's perception of lessened sensitivity, and as tacit approval by "negative implication" of the California court's new constitutional jurisprudence. These fundamental errors in constitutional jurisprudence, now law in California, will multiply while this case remains unreviewed, and other state courts stray down the same misguided path.

CONCLUSION

The United States cannot afford worldwide combined reporting. International trade is more important than ever to the United States. Worldwide combined reporting interferes with the federal government's efforts in furtherance of United States foreign economic policy to secure a uniform standard for division of income for tax purposes among nations. The furtherance of that standard depends on international cooperation and agreement. The decision below, by dismissing the cooperative efforts of nations, led by the United States, as "Executive Branch aspirations," threatens to dismantle over fifty years of effort by our federal government.

This Court said two decades ago:

> We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.

The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 9 (1971). The decision below ignores these words and threatens to bring harm to the nation as a whole.

For the foregoing reasons, the Institute of International Bankers believes that this Court should grant the writ of certiorari in this case.

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INTEREST OF THE AMICI CURIAE

The amici curiae are organizations representing a wide spectrum of U.S. business interests, including both large and small, domestic and multinational, and U.S.- and foreign-owned companies. All share a strong commitment to principles of domestic and international free trade. Each is concerned that California's taxation of

foreign-owned multinational businesses under a worldwide combined reporting method impairs U.S. foreign economic relations, threatens to incite destructive retaliatory measures by foreign governments, and endangers U.S. business and the U.S. economy. International economic tensions, and especially the threat of foreign reprisals, artificially impede U.S. trade and restrict the flow of capital in global markets, dampening both foreign investment in the United States and U.S. investment abroad. Amici believe that the question presented by the petition for certiorari in this case requires urgent resolution by this Court to avert these undesirable consequences.

Additional information about each of the amici curiae is set forth in the Appendix hereto.

Counsel for the parties have consented to the filing of this brief in letters filed with the Clerk of the Court.

SUMMARY OF ARGUMENT

This case squarely presents the question expressly reserved by this Court in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983): whether the Foreign Commerce Clause permits California to apply its worldwide combined reporting method of apportioned income taxation to a foreign-owned unitary business. The Court in *Container* upheld California's system as applied to a U.S.-owned company. Its analysis there requires a different result here.

The Court in *Container* concluded that California's worldwide unitary tax method did not seriously threaten the ability of the United States to speak with "one voice" in conducting foreign affairs. In the absence of advice from the Executive Branch, whose province comprises the nuances of foreign policy, the Court saw little objective reason to suppose that a tax levied on a domestically based multinational business would "justifiably lead to significant foreign retaliation." 463 U.S. at 194.

Here, by contrast, the Secretary of State advised the Governor of California that the state's worldwide unitary tax method "has become a source of conflict with foreign states," "has seriously complicated our economic relations with many of our closest allies," has triggered formal protests "from virtually every developed country in the world," and "greatly impair[s] the ability of the federal government to carry out its tax and investment policy in the international arena." Pet. App. F45-46. The United States, appearing as amicus curiae before the California Supreme Court, advised that the state's taxing method "is in conflict with the internationally accepted standard and policies," "has caused serious disputes and difficulties for the United States in the conduct of foreign affairs," and "constitutes an impermissible interference in the conduct of the nation's foreign affairs." *Id.* at F18, F35-36. Moreover, as the California Court of Appeal stated, "we do not have to speculate on whether the taxation method at issue may offend our foreign trading partners and lead them to retaliate against the nation as a whole. They are offended; they have retaliated." *Id.* at B27 (citation omitted).

Differences of principle as well as practicality explain why the foreign reaction is so much stronger when California applies its tax to a foreign-based company. First, it is a fundamental precept of international law, and an underlying theme of *Container*, that a nation may tax its own domiciliaries as it chooses. The balance of interests shifts when one nation seeks to tax the domiciliary of another in a manner at odds with international norms. Second the record here demonstrates that the compliance burdens for foreign companies far exceed those for domestic companies, adding a discriminatory gloss to a tax system that already offends foreign nations.

The California Supreme Court refused to weigh these considerations despite their obvious importance to the analysis prescribed by *Container*. In its view, this Court's

decision in *Wardair Canada Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986), "reoriented" and "reduced the scope" of the dormant Foreign Commerce Clause doctrine (Pet. App. A19), allowing courts to bypass the *Container* analysis if they can infer from Congressional *silence* a federal decision to acquiesce in a particular form of state taxation. *Wardair* did no such thing. On the contrary, it held that Florida could lawfully tax sales of aviation fuel to foreign as well as domestic airlines because Congress had "*affirmatively acted* [on the subject], rather than remained silent." 477 U.S. at 9 (emphasis added). Nothing in *Wardair* or any other decision of this Court supports the California Supreme Court's novel theory that Congressional *in*action can validate a state statute that otherwise would violate the Commerce Clause.

Plenary review by this Court is urgently needed to stave off a potentially destructive cycle of international retaliation that would interfere with foreign trade, disrupt international flows of capital and technology, and harm U.S. commercial interests abroad. The international community has closely watched this case and has deferred implementation of retaliatory measures pending the outcome in this Court. California's tax system is a current and significant irritant in our foreign commercial relations, and delay in addressing its lawfulness risks exhausting the patience of our trading partners.

ARGUMENT

I. CALIFORNIA'S WORLDWIDE COMBINED REPORTING METHOD OF APPORTIONED TAXATION, AS APPLIED TO FOREIGN-OWNED MULTINATIONAL BUSINESSES, VIOLATES THE FOREIGN COMMERCE CLAUSE

A. California's Worldwide Unitary System Impairs Federal Uniformity and Prevents the Federal Government from Speaking with One Voice in Its Commercial Relations with Foreign Governments

In granting to Congress the "Power . . . To regulate Commerce with foreign Nations," U.S. Const. art. I, § 8, cl. 3, the Framers recognized that "[f]oreign commerce is preeminently a matter of national concern." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979). This Court accordingly has held that a state tax is unconstitutional under the Foreign Commerce Clause if it "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* at 451 (quoting *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 285 (1976)).

In *Container*, the Court upheld California's worldwide combined reporting method of apportioned income taxation as applied to a U.S.-owned multinational unitary business.[1] The Court expressly reserved the question whether the California system would be lawful as applied to "domestic corporations with foreign parents or foreign corporations with either foreign parents or foreign sub-

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[1] Under the "worldwide combined reporting method," a taxpayer aggregates the income of all the entities that compose its unitary business throughout the world and apportions a share of the total to California under the familiar three-factor formula of property, payroll, and sales. Under the "arm's-length/separate accounting method," by contrast, each corporation is treated as a separate entity taxable only by the jurisdictions in which it operates and only on its own income; transfers between affiliated entities are deemed to occur at arm's length and must be reported on that basis in determining taxable income.

sidiaries." 463 U.S. at 189 n.26. This case presents precisely that question.

The record here leaves little room for doubt that California's worldwide combined reporting method, as applied to foreign-owned businesses, offends the Foreign Commerce Clause. It is one thing for a sovereign nation to tax (or allow a subnational authority to tax) its own corporate domiciliaries under a system at odds with international norms. It is quite another (and a far more provocative) thing for that nation to tax *foreign* businesses under an internationally disfavored system, all the more so if the taxing nation has been the principal moving force in establishing the prevailing international standards for the taxation of multinational businesses. That is this case.

The trial court found that the arm's-length/separate accounting method of taxation "is universally used and favored" while worldwide combined reporting "is everywhere disliked." Pet. App. C21; see also *id.* at A8 n.6. As the Court of Appeal observed, "no other country in the world uses [worldwide combined reporting]." *Id.* at B23. California's departure from the international norm and its embrace of an abberational method excites particularly strong reactions from the international community because of "the critical role the United States has played in attempting to construct a coherent and nondiscriminatory tax policy for all nations based on the [arm's-length] method." *Id.* at B26. It is of no comfort to other nations that the tax at issue is imposed by a state rather than the federal government. As petitioner notes (Pet. 26), if California were a separate nation, its economy would rank seventh or eighth in the world. It is no wonder that its tax policies have global reverberations.

The worldwide combined reporting method imposes far more costly compliance burdens on foreign-owned than on U.S.-owned unitary groups. As the Secretary of State explained in a letter to the Governor of California, "[t]he

information required by the tax authorities of the jurisdiction practicing a worldwide unitary method of taxation may not be readily available to the enterprise and . . . will require costly conversion into a form usable by the jurisdiction's tax authority." Pet. App. F45-46. Indeed, the trial court found that "literal compliance . . . is impossible, because no foreign multi-national maintains appropriate accounting books." *Id.* at C27. The cost to reconstruct the necessary information for past periods would be "prohibitive"; the cost to set up and maintain systems to obtain the information for future periods would be so "huge" that even the state conceded the burden would be unreasonable. *Id.* at C27-28. The California Court of Appeal aptly characterized the compliance problem as an "administrative nightmare for the foreign-based multinational." *Id.* at B25.

Not surprisingly, the worldwide combined reporting method of state taxation has provoked an extraordinary degree of "international furor" (*id.* at C24), bringing the United States into unprecedented economic conflict with its trading partners. The Secretary of State advised the Governor of Calfornia that the United States "has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world." *Id.* at F46. The record reflects that "[t]hese protests have been sharp. frequent, and incessant over a number of years." *Id.* at B22.

The threat of international economic retaliation against United States interests is very real. Indeed, the United Kingdom, frustrated by this nation's inability to eliminate worldwide combined taxing methods, adopted retaliatory legislation in 1985. It withdraws from U.S. parent corporations operating in worldwide combination states certain tax benefits relating to the payment of dividends by their U.K. subsidiaries. *Id.* at B22-23. Although the United Kingdom has thus far deferred implementation of the legislation while awaiting the outcome of litigation in

the U.S. courts, concerns about possible retroactive penalties "impelled many American companies into preimplementation compliance" (*id.* at B23), with the result that some companies altered their normal policy for the repatriation of dividends from U.K. subsidiaries and declined to claim benefits properly available to them under the applicable treaty. *Id.* at F46.

U.S. trading partners have expressed their displeasure in other ways as well. For example, some nations have cancelled trade missions to states that applied worldwide combined reporting methods to foreign-based multinationals. *Id.* at B23. According to the Secretary of State, tensions over this issue have "seriously complicated our economic relations with many of our closest allies" and have been "partially responsible for stalling some bilateral tax treaty negotiations." *Id.* at F46. In his view, "[c]ontinued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation." *Id.*

In sum, in the words of the Secretary of State, "worldwide unitary taxation is adversely affecting the United States' foreign economic relations." *Id.* The United States, appearing as amicus curiae, accordingly advised the California Supreme Court that it considers the state's taxing method "an egregious interference with the Federal Executive's conduct of foreign affairs." *Id.* at F26 n.13.

While pursuing its tax policy according to its own parochial interests, California has thus hobbled the federal government in its pursuit of important foreign economic policy goals and has placed the whole nation at risk of international commercial retaliation. The Foreign Commerce Clause was meant to foreclose just such inappropriate state intrusions into international affairs.

The Articles of Confederation had restricted the power of the national government and had given the states ple-

nary authority over foreign commerce. That experiment failed, *see Brown v. Maryland*, 25 U.S. (12 Wheat.) 419, 445-46 (1827), and the Constitution marked a dramatic reversal. In place of the states' "partial and separate regulations," 1 J. Elliott, *Debates on the Federal Constitution* 114 (2d ed. 1888), the Convention of 1787 sought a "vigorous national government . . . directed to a common interest." *The Federalist No. 11*, at 69 (Hamilton) (J. Cooke ed., 1961). The Framers believed that, "[i]f we are to be one nation in any respect, it clearly ought to be in respect to other nations." *The Federalist No. 42*, at 279 (Madison) (J. Cooke ed., 1961). The Foreign Commerce Clause accordingly reassigned from the states to Congress the power "[t]o regulate Commerce with foreign Nations."

The Framers recognized that an individual state, acting in furtherance of its own commercial interests, might enact legislation that would incite foreign reprisals. Even though provoked by a single state's tax measure, such commercial retaliation "of necessity would be directed at American [interests] in general, not just that of the taxing State, so that the Nation as a whole would suffer." *Japan Line*, 441 U.S. at 450. *See also Kraft General Foods, Inc. v. Iowa Dep't of Revenue & Finance*, 112 S. Ct. 2365, 2370 (1992). The Foreign Commerce Clause thus sought to ensure that measures bearing a high risk of international commercial discord would lie within the sole discretion of the national government, acting in the collective self-interest of all the states, rather than within the power of each individual state acting by its own lights. "If it be otherwise, a single State can, at her pleasure, embroil us in disastrous quarrels with other nations." *Chy Lung v. Freeman*, 92 U.S. 275, 280 (1876).

That is what California has done in the case of its worldwide unitary method of taxation, and that is why the tax must be struck down. As the trial court found, "[t]his case factually demonstrates as extreme an example of predictable international consequences stem-

ming from a local tax as can be conceived." Pet. App. C23. This Court's words in *Japan Line* apply here with full force: "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453.

B. Congressional Silence Cannot Validate an Otherwise Unconstitutional State Statute

The California Supreme Court did not deny that dormant Foreign Commerce Clause considerations would require invalidation of the state's tax method. In fact, the court acknowledged that Barclays' argument might have carried force had it been presented "in the immediate aftermath of the *Container* decision." Pet. App. A19. The court held, however, that this Court's decisions after *Container* had "reoriented" (*id.*) dormant Foreign Commerce Clause doctrine, making resort to traditional considerations inappropriate (and apparently rendering *Container* inoperative) wherever Congressional *inaction* implies a legislative intention to permit the state taxation at issue. As the California Supreme Court put it, this Court's recent jurisprudence "reflects a diminution in the reach of dormant foreign commerce clause analysis in favor of an expanded recognition that, under circumscribed conditions, *governmental silence* may constitute a ratification of state taxation of foreign commerce, rendering a dormant analysis inapposite." *Id.* at A4 (emphasis added).

This novel theory rests on a dangerous misreading of this Court's precedents. It is true, of course, that when Congress has "taken affirmative action" expressly consenting to a form of state taxation, the courts are not free to invalidate the tax under the dormant Commerce Clause. *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 421 (1946). It is equally true, however, that only a clear expression of Congressional consent will suffice to validate an otherwise unconstitutional state law. As

the Court reiterated only last Term, "Congress must manifest its *unambiguous* intent before a federal statute will be read to permit or approve . . . a violation of the Commerce Clause." *Wyoming v. Oklahoma*, 112 S. Ct. 789, 802 (1992) (emphasis added). *See also Maine v. Taylor*, 477 U.S. 131, 138-39 (1986); *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 960 (1982). Indeed, "[t]he need for affirmative approval is heightened" when a state's policy "has substantial ramifications beyond the Nation's borders"; in those circumstances, "[t]he need for a consistent and coherent foreign policy . . . enhances the necessity that congressional authorization not be lightly implied." *South-Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 92 n.7 (1984).

The California Supreme Court identified no "affirmative" Congressional action authorizing the use of worldwide combined reporting methods of taxation. Instead, it relied primarily on the Senate's narrow failure in 1978 to ratify a bilateral income tax convention that included a prohibition against worldwide unitary taxation. Pet. App. A27-31. As the Court of Appeal noted, however, the Senate voted 49 to 32 to *approve* the convention, falling only five votes short of the necessary ⅔ majority. *Id.* at B20. Opposition to the relevant provision "was rooted not in the substance of the article but in the procedural wariness of addressing the problem through patchwork treaties rather than through comprehensive legislation." *Id.* In these circumstances, the Senate's ultimate approval of the convention without the controversial restriction can hardly be construed as an affirmative endorsement by that body, much less by the entire Congress, of the state laws to which the restriction was directed.

The California Supreme Court mistakenly believed that this Court's decision in *Wardair Canada Inc. v. Florida Dep't of Revenue*, 477 U.S. 1 (1986), prescribed a "protocol for identifying those kinds of governmental silences" that imply federal ratification of a state's power to impose a challenged tax. Pet. App. A23. On the contrary, this

Court in *Wardair* emphasized that "we do *not* confront federal governmental silence" because "the Federal Government has *affirmatively acted*, rather than remained silent." 477 U.S. at 9 (emphasis added). It also reaffirmed the rule, overlooked by the California Supreme Court, that when the federal government "has *not* affirmatively acted, . . . it is the responsibility of the judiciary to determine whether action taken by state or local authorities unduly threatens the values the Commerce Clause was intended to serve." *Id.* at 7 (emphasis added).

The circumstances in *Wardair* make clear that the California court's mistake was not merely semantic. The question was whether the Foreign Commerce Clause precluded Florida from applying to foreign airlines a sales tax on aviation fuel purchased within the state. The Federal Aviation Act, in a section entitled "State taxation of air commerce," expressly prohibited certain forms of state taxation and expressly authorized others. Among the authorized taxes were "sales or use taxes on the sale of goods or services." *Id.* at 6-7. That was enough for Chief Justice Burger, who concluded in a concurring opinion that "the Florida tax—even in the area of foreign air commerce—is expressly authorized by Congress." *Id.* at 17. The majority, however, thought it was "plausible that Congress never considered whether States should be permitted to impose sales taxes on foreign, as opposed to domestic, carriers." *Id.* at 7. It therefore looked beyond the statute for confirmation that the unqualified statutory authorization embraced taxes on sales to foreign carriers as well as domestic.

The Court did not have to look far. An international convention to which the United States was a party "preclude[d] the imposition of local taxes on fuel *only* when the fuel is 'on board an aircraft . . . on arrival . . . and retained on board on leaving' a contracting party; it [did] not prohibit taxation of fuel purchased in that country." *Id.* at 10 (emphasis added). The convention thus reflected an affirmative decision "curtailing and

limiting only some of the localities' power to tax [sales of aviation fuel], while implicitly preserving other aspects of that authority." *Id.* Unlike this case, where Congress has taken no affirmative action at all on the issue of worldwide combined reporting, it was clear in *Wardair* that "the Federal Government has *not* remained silent" but "has *affirmatively decided* to permit the States to impose these sales taxes on aviation fuel." *Id.* at 12 (emphasis added).

The California court's misguided holding that governmental silence can ratify an otherwise unconstitutional state taxing regime thus finds no support in this Court's precedents. It is also unworkable, requiring courts to distinguish between "species" of Congressional silence that are constitutionally neutral and those that supposedly are "eloquent." Pet. App. A21, A39. This quixotic inquiry, which defies meaningful guidance or limitation, is likely to produce capricious and inconsistent outcomes incompatible with this Court's traditional insistence upon an explicit and unambiguous expression of Congressional consent.

II. THE ISSUE HAS ENORMOUS PRACTICAL IMPORTANCE FOR THE U.S. ECONOMY AND WARRANTS URGENT RESOLUTION BY THIS COURT

In the nearly 10 years since this Court's decision in *Container*, perhaps no other U.S. legal issue has been the subject of more widespread and intense international concern than the constitutionality of worldwide combined taxation as applied to foreign-owned multinationals. The international community, while expressing through diplomatic channels its strong objections to the practices of California and other states, has for the most part deferred adopting retaliatory measures in anticipation of this Court's resolution of the issue. A denial of review at this stage, after many years of litigation in the California courts and in the face of an adverse ruling by the

highest court of the most significant worldwide unitary state, would almost certainly be understood by foreign governments as the final judicial word on the subject.

A number of our major trading partners have already threatened economic reprisals against the United States unless the worldwide unitary issue is resolved compatibly with international norms. Allowing the California decision to stand could well provoke a cascade of international retaliatory actions, the consequences of which for the U.S. economy, for U.S.-owned foreign businesses, and for the global economy as a whole are likely to be extremely damaging. At a minimum, government-imposed economic countermeasures will almost certainly skew international investment decisions, disrupting the flow of foreign capital into the United States and reducing the attractiveness of foreign investment for U.S. businesses. If other nations were to follow the lead of the United Kingdom, for example, it may become significantly more costly for U.S. subsidiaries abroad to repatriate dividends to their domestic parent corporations. That additional cost would necessarily enter into any investment determination by a U.S. business, with the result that capital is likely to be deployed in other than the most efficient manner.

There is no reason to delay plenary consideration of the constitutional issue. This case is unusually well postured for review. The legal issue is squarely framed. The record is exceptionally complete. All three courts below have addressed the facts and the law at substantial length. The Commerce Clause question can be answered definitively only by this Court, and this case provides an excellent vehicle for resolving it.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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SEPTEMBER 1992

APPENDIX

APPENDIX

This brief is submitted on behalf of the following amici curiae:

National Foreign Trade Council, Inc.

The National Foreign Trade Council, established in 1914, consists of approximately 500 manufacturing companies, financial institutions, and other firms with substantial international operations and interests. Its members account for more than 60 percent of all U.S. nonagricultural exports and 60 percent of all U.S. private foreign investment. The NFTC's purpose is to develop policies designed to expand exports, protect U.S. foreign investment, enhance the competitiveness of U.S. industry, and promote and maintain a fair and equitable international trading system.

National Association of Manufacturers

The National Association of Manufacturers is a nonprofit voluntary business association consisting of more than 12,000 manufacturing and related businesses operating in the United States and worldwide. NAM supports a taxing system that encourages the competitiveness of U.S. manufactured goods in domestic and foreign markets.

Chamber of Commerce of the United States of America

The U.S. Chamber of Commerce is the largest federation of business companies and associations in the world. With substantial membership in each of the 50 states, the Chamber represents approximately 200,000 businesses and organizations and serves as a major voice of the American business community. It has a strong interest in tax measures that impact on the competitiveness of U.S. industry and on the U.S. economy.

United States Council for International Business

The United States Council advances the global interests of American business both at home and abroad. It is the American affiliate of the International Chamber of Commerce, the Business and Industry Advisory Group to the Organization for Economic Cooperation and Development, and the International Organization of Employers. The Council officially represents U.S. business positions in the main intergovernmental bodies and in dealings with foreign business and foreign governments. Working with its membership of about 300 corporations, law firms, and associations, the Council addresses policy issues affecting an increasingly globally oriented American business community. Its objective is to promote an open system of world trade, finance, and investment.

Emergency Committee for American Trade

The Emergency Committee for American Trade is an organization of the leaders of approximately 60 large U.S. firms with extensive international business operations. Their annual worldwide sales total well over $1 trillion, and they employ more than five million workers. ECAT's mission is the advocacy of open international economic policies that will expand international trade and investment.

American Petroleum Institute

The American Petroleum Institute is a trade association that represents approximately 300 companies involved in all aspects of the oil and gas industry, including exploration, production, transportation, refining, and marketing. Many of its members conduct extensive business operations in foreign countries. API's mission includes promoting the interests of the petroleum industry in the development of national policy conducive to a favorable domestic and international business environment.

Chemical Manufacturers Association

The Chemical Manufacturers Association is a non-profit trade association whose member companies represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. The U.S. chemical industry provides jobs for 1.1 million American workers. In 1991, the chemical industry was the largest exporting sector of the U.S. economy, with exports of $43 billion that produced a net trade surplus of $18.2 billion. CMA and its members have a vital interest in issues affecting international trade and U.S. foreign economic relations.

Financial Executives Institute

The Financial Executives Institute, founded in 1931, is a professional association of 14,000 senior financial executives representing over 8,000 major companies throughout the United States and Canada. Through its technical committees, FEI formulates positions on a variety of tax, employee benefits, international trade, and public policy issues of concern to corporate financial executives.

California Chamber of Commerce

The California Chamber of Commerce represents 5,000 member companies, 160 member trade associations, more than 400 affiliated local chambers of commerce, and a statewide network of 168,000 small business owners. Its members include firms of all sizes from every industry throughout California. Among the Chamber's missions is to help member firms stay competitive in the fast-changing global marketplace and to promote their interests in matters affecting international trade.

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IN THE

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BARCLAYS BANK PLC,
Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of the State of California

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BRIEF OF THE MEMBER STATES OF THE EUROPEAN COMMUNITIES AND THE GOVERNMENTS OF AUSTRALIA, AUSTRIA, CANADA, FINLAND, JAPAN, NORWAY, SWEDEN AND SWITZERLAND AS AMICI CURIAE SUPPORTING PETITIONER

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Letter from Ambassador of Spain on behalf of Member States of the European Communities to U.S. Secretary of State, James A. Baker, III, June 30, 1989 4

Demarche from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities July 22, 1992 4

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BRIEF OF THE MEMBER STATES OF THE EUROPEAN COMMUNITIES AND THE GOVERNMENTS OF AUSTRALIA, AUSTRIA, CANADA, FINLAND, JAPAN, NORWAY, SWEDEN AND SWITZERLAND AS AMICI CURIAE SUPPORTING PETITIONER

INTEREST OF AMICI CURIAE

The issue presented to this Court by Petitioner's petition for certiorari is the constitutionality of the application by the Respondent Franchise Tax Board of the State of California ("Respondent") of the method of corporate income allocation known as worldwide combined reporting ("WWCR") to domestic corporations with foreign parents, or foreign corporations with either foreign par-

ents or foreign subsidiaries. This Court reserved resolution of that issue in 1983 when it considered the constitutionality of Respondent's use of WWCR to tax the income of U.S. based multi-corporate groups.[1]

Determination of that question is of significant importance to the twelve member countries of the European Communities: Belgium, Denmark, France, Federal Republic of Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, and the United Kingdom; and to the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland (herein "the Twenty Countries") and to their future economic and commercial relations with the U.S. The Twenty Countries are the United States' main trading partners, accounting for more than one-half of U.S. trade. Each of the Twenty Countries have a double taxation and/or friendship, commerce and navigation treaties in force with the United States, the effect of which is to forbid the use of WWCR.

Corporate citizens of the Twenty Countries are adversely affected by Respondent's use of WWCR. While claiming to be taxing one corporation's operations in California, Respondent includes in its tax base and apportionment formula its income and property, payroll and sales factors and the income and factors for the worldwide operations of all foreign corporations considered to be conducting a unitary business with it, with no provision for crediting the taxes already assessed upon such income in the foreign jurisdiction in which it was earned.

The Twenty Countries hereby submit this brief *amicus curiae* in support of Petitioners.[2]

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[1] *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 189 n.26 (1983).

[2] Petitioners and Respondent have consented to the filing of this brief *amicus curiae* in letters filed with the Clerk of this Court.

SUMMARY OF ARGUMENT AND ARGUMENT

The Twenty Countries have repeatedly expressed their formal objections to Respondent's use of WWCR as:

(1) contradictory to, and incompatible with, accepted international principles of corporate tax assessment and the purpose of double taxation and/or friendship, commerce and navigation treaties in force between the Twenty Countries and the U.S.;

(2) an impediment to investment and trade with the U.S.[3]

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[3] Protocol to the Convention with France on Income Taxes, signed Nov. 24, 1979, 2 Tax Treaties, (CCH) 2819-23T; Demarche from Italy, President European Communities, on behalf of the Member States of the European Communities, March 13, 1980; Demarche No. 51 from the United Kingdom Embassy, March 25, 1980; Demarche No. 211 from the United Kingdom, President European Communities, on behalf of the Member States of the European Communities, October 30, 1981; Demarche No. 83 from the United Kingdom Embassy, May 18, 1982; Demarche from Belgium, President European Communities, on behalf of the Member States of the European Communities, June 29, 1982; Demarche from Greece, President European Communities, on behalf of the Member States of the European Communities, August 1, 1983; Aide-Memoire from Government of Japan, August 11, 1983; Demarche from Greece, President European Communities, on behalf of the Member States of the European Communities, September 23, 1983; Demarche No. 383/83 from Embassy of Australia, November 7, 1983; Demarche No. 461.20-LJ/hu from Embassy of Switzerland, November 15, 1983; Demarche from the Republic of Germany, November 28, 1983; Demarche EA-14533 from Embassy of the Netherlands, December 21, 1983; Demarche from Belgium, President European Communities, supported by the Member States of the European Communities, the European Commission, and the Embassies of Australia, Japan, Canada, and Switzerland, January 1, 1984; Demarche from Embassy of Belgium, January 25, 1984; Aide-Memoire from Government of Japan, June 6, 1984; Demarche from Ireland, President European Communities, on behalf of the Member States of the European Communities, December 20, 1984; Demarche from the Commission of the European Communities and the Embassy of Luxembourg, August 8, 1985; Demarche from Member States of the European Communities and the Commission of the European Com-

The Twenty Countries have also brought their objections to WWCR to the attention of both state and Federal courts by filing *amicus curiae* briefs. This *amicus curiae* brief is the latest expression of the Twenty Countries' objections to Respondent's use of WWCR.

The Twenty Countries are anxious to have the question of the constitutionality of the Respondent's application of WWCR to domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, resolved before more harm is done to their relations with the United States and to prevent the continued double taxation of their corporate citizens.

CONCLUSION

The Twenty Countries ask that Petitioner's petition for certiorari be granted.

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